Common Law Trusts as Business Enterprises

Robert C. Brown

Indiana University School of Law

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A generation ago the “trust problem” was under very active discussion in this country both by the legal profession and by the general public. The word “trust” had deviated widely from its original meaning to designate one of the most unique and highly beneficial devices of courts of equity—though it is probable that few of the laity had ever heard of this primary meaning—and had become a synonym for those monopolistic combinations which were believed to menace the normal economic development, and possibly the political freedom, of the country.

As is quite generally known, the designation of these combinations by the term “trusts,” was largely a historical accident. In the beginning of the development, a few of the most prominent of these organizations actually adopted the trust form, in that stock of constituent corporations was put into the hands of trustees who were to manage the entire enterprise. Later a holding corporation was more generally used and at times the constituent corporations were dissolved or became mere shells. But during the entire period the term “trusts” continued to be applied to these monopolies not merely by the public but by the legal profession, and the statutes enacted against them were frequently called “anti-trust laws.”

Meanwhile, the courts, with or without the aid of statutes, applied themselves with great vigor to doing away with such

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* See biographical note, p. 649.

1 For example the “Sherman Anti-Trust Law.”
trusts. Dissolution decrees were frequent, though the substantial economic effect of these activities is problematical. But at any rate the trust problem is today one which creates little public interest and, perhaps for that reason, causes comparatively little judicial activity. Whether it is because the present generation thinks the existing monopolies are well behaved or because we do not feel that substantial monopoly is now possible except with respect to public utilities, which are supposedly under governmental regulation, it is certain that the trust problem is not one which even the most astute political spell-binder can use to much advantage at present. To the ordinary “man of the street” the trust has almost ceased to exist. Not so to the courts nor to business men, either, for there is evident a considerable tendency toward the formation of trusts for carrying on ordinary businesses. These trusts are not formed for monopolistic purposes—though of course that may be the purpose and if so they would be subject to such statutes and common law principles as are still applied against monopolies—but are primarily intended to take the place of corporate organizations in small businesses, and are being adopted because of the existence of the greater convenience and flexibility (whether actual or supposed) in the organization and management of trusts as compared with corporations. It is this form of trust which is the subject of this article.

In both popular and legal use these trusts are very generally referred to as “Massachusetts trusts.” This also is a purely historical accident. The trust for business purposes grew up in Massachusetts rather early and is even now better developed in that commonwealth than in most other jurisdictions. The reason is somewhat problematical although it has been suggested that it was due to unusual restrictions upon the holding of real estate in Massachusetts by corporations. At any rate the name “Massachusetts trust” seems to be in favor, although perhaps “common law trust” or better still “business trust” would be more desirable. However “common law trusts” will not do in Massachusetts itself or in Oklahoma or Wisconsin, for these states have statutes regulating such organizations.

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The Massachusetts trust may perhaps be defined simply as a trust formed for the purpose of carrying on business. As such, it is unquestionably a somewhat modern development although testamentary trusts have been established for this purpose for a very long time.\(^5\) But the Massachusetts trust was more directly an outgrowth of the line of development begun by *Cox v. Hickman*,\(^6\) which held that a trust formed to carry on the business of an insolvent partnership in the interest of its creditors was itself valid and did not subject the trustees to liability as partners. Then as a natural development came the formation of trusts merely as machinery for securing the lenders of money. Nearly all bond issues involve the creation of a trust, the property being mortgaged to a trustee. Even more clearly is this the case with respect to railroad car trusts. And then came the trust for controlling and securing investments, first the corporate voting trust and then the trust which actually makes it its business to invest in securities and change investments as considered desirable—the purpose being primarily the diversification of investments so as to lessen the risk of the investors who take the position of *cestuis* of the trust. These investment trusts have had an extraordinary development in our large financial centers in the years since the war, but were well known and quite extensively used before that time, especially in England.\(^7\)

From investment trusts, especially where the investments were constantly subject to change and required the careful attention of the trustees, to business trusts, is obviously a short step. The line between investment and the carrying on of business is often a very tenuous one, as has been shown frequently in the case of corporations. The legality of the Massachusetts trust *per se* seems therefore indisputable in theory. It should be remembered, however, that such trusts may be used for improper purposes and if so the trustee and other parties interested may be subject to the same penalties as would apply in any other case of violation of statutes or of rules of public

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\(^5\) *Ex parte Garland*, 10 Ves. Jr. 111 (1804); *In re Raybould* (1900) 1 Ch. 199; *Woddrop v. Weed*, 154 Pa. 307, 26 Atl. 375 (1893).

\(^6\) 8 H. L. C. 203 (1860). See also *Re Stanton Iron Co.*, 27 Beav. 474 (1855), which involves the same organization. *Wells-Stone Mercantile Co. v. Glover*, 7 N. D. 460, 75 N. W. 81 (1898), and *In re Hoyne*, 277 Fed. 668 (1922) are American cases following the doctrine of *Cox v. Hickman*. See also *Sullivan v. Edward Hines Lumber Co.*, 239 Ill. App. 1 (1925).

\(^7\) *See Johnson v. Lewis*, 6 Fed. 27 (1881), which involves an English investment trust.
policy. For example, a trust of this nature formed by a single person for the carrying on of his own business is clearly void, at least as respects the creditors of the person forming it.\(^8\) In Attorney-General v. New York, New Haven and Hartford Railway Co.,\(^9\) it was held that a railroad could not form a trust for the purpose of evading a statute prohibiting it from holding stock of its competitors (a suggestion of the renewal of trusts for monopolistic purposes).\(^10\) A business trust has also been held subject to the statutes providing for post office investigation.\(^11\) All of these holdings are obviously correct, for it would be intolerable that this device should be used as a means of evading statutory restrictions upon business or even judicial rules of public policy.

MASSACHUSETTS TRUSTS AS DISTINGUISHED FROM PARTNERSHIPS AND CORPORATIONS

It must be fairly obvious, however, that merely calling a business organization a trust will not necessarily make it so. Such an organization may conceivably be a partnership; also, according to some courts at least, it may be a corporation. Obviously these distinctions may be of very serious practical importance.

With respect to partnership, the distinction very largely depends upon principles of agency. If the so-called trustees are in fact the agents of the "cestuis" the latter must be considered to be the principals and as such, to carry on the business as partners. If the number of cestuis is large, the courts are inclined to regard them as a joint stock association, but of course for most purposes a joint stock association is in legal effect a partnership.\(^12\)

The test with respect to this matter is a dual one: First, how much power have the trustees to act independently of the cestuis, and secondly, to what extent are the cestuis associated together? It would seem that the test of the control of the cestuis over the trustees is the more important one, since unless such control exists there must be in effect a trust even though

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\(^8\) Cunningham v. Bright, 228 Mass. 385, 117 N. E. 909 (1917).
\(^9\) 208 Mass. 497, 94 N. E. 808 (1911). But in Weeks v. Sibley, 269 Fed. 155 (1920) a trust formed merely to permit the liquidation of a corporation without subjecting the stockholders to income tax, was held valid.
\(^10\) See p. 595.
\(^12\) But see Haiku Sugar Co. v. Johnstone, 249 Fed. 103 (1918), where the distinction between an association and an ordinary partnership is clearly pointed out.
the *cestuis* are associated. On the other hand, an association of the *cestuis* is undoubtedly strong evidence of substantial control by them of the activities of the trustee—since otherwise there is no possible reason for such association. The test of association is therefore chiefly important as evidence with respect to the more fundamental test of control.

The tendency of the authorities, especially in Massachusetts itself, has been to apply these tests with considerable rigidity—that is to say, very slight control of the trustees' action by the *cestuis* and very slight association of the *cestuis* has been deemed sufficient ground to condemn the attempted trust as a mere partnership. There are a number of cases to this effect in Massachusetts, most of the earlier ones being summarized in *Williams v. Milton*, which is the leading case on the subject. Here the trust in question was held to be a trust in fact and the previous cases were discussed and where necessary distinguished. The difference between the cases finding a partnership and those where a true trust has been held to exist, was stated to be "in the fact that in the former cases the certificate holders are associated together by the terms of the 'trust' and are the principals whose instructions are to be obeyed by their agent, who for their convenience holds the legal title to their property, the property is their property, they are the masters; while in (a case of the true trust), on the other hand there is no association between the certificate holders, the property is the property of the trustees and the trustees are the masters." In the trust in question in the case, the certificate holders (the certificates represent the beneficial interests) were in no way associated and there was no provision for meetings of certificate holders, although they could (acting individually) consent to action for amendments or termination of the trust, which had been initiated by the trustees. The trustees had full power to manage the property and business, limited only by the specific terms of the trust instrument, and the certificate holders had no interest other than to receive their share of the profits. The court had no difficulty in reaching the conclusion that this was a true trust.

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15 See note 13.
It can hardly be contended that the Massachusetts cases have been entirely consistent with respect of their application of this test—for instance *Williams v. Milton* \(^{17}\) itself overrules *Williams v. Johnson*, \(^{18}\) where an attempted real estate trust had been held to be a partnership although the trustee had sole power of management—but the general tendency has been to follow the test laid down in *Williams v. Milton*. Thus in *Frost v. Thompson* \(^{19}\) the trust was held to be in fact a partnership because of the control over the trustees' action which the *cestuis* had the right to exercise; but these powers of control were hardly broader than those which stockholders of a corporation may exercise with respect to directorate action. In the more recent case of *Baker v. The Commissioner*, \(^{20}\) however, a trust instrument with provisions that the majority of the certificate holders could approve or disapprove the filling of vacancies in the trustees by the trustees and that by three-fourths vote they could amend the trust instrument itself were held insufficient to change the trust into a partnership. But the Massachusetts rule is probably still fairly represented by *Williams v. Milton* \(^{21}\) and it apparently means that if the *cestuis* have power to elect trustees (including the filling of vacancies in the board) to remove trustees or to instruct the trustees in any matter whatever, there is danger that the trust will be considered a mere partnership. It seems, also, that any provision for meetings of certificate holders is likewise dangerous, although the right of individual approval or disapproval of fundamental changes in the organization of the trust which have been proposed by the trustees, may be given to the certificate holders.

It has often been urged that this test is too severe. The suggestion is made that the certificate holders should have the same power as stockholders in a corporation—that is to say that they should at least have power to hold meetings for ratification or disapproval of trustees' action and that they should have power

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\(^{16}\) *Mayo v. Moritz*, supra, note 13, is the case taken.

\(^{17}\) *Supra*, note 14.

\(^{18}\) *Supra*, note 13.


\(^{21}\) *Supra*, note 14.
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24 15 Ch. D. 24 (1880). See also In re Siddall, 29 Ch. D. 1 (1885).

25 See I. P. Hildebrand, "The Massachusetts Trust," 1 Texas Law Review, 127. It must be noticed, however, that the test is the power granted to the certificate holders, not alone what they actually exercise.

to elect and remove trustees or at least to fill vacancies in the board arising through the death or removal of trustees. This argument has considerable plausibility and has been accepted in some of the cases. Conspicuous among these is Rhode Island Hospital Trust Co. v. Copeland. Here the certificate holders were given the right to remove trustees and appoint new trustees to fill vacancies, and could also, by two-thirds vote, amend the declaration of trust, or terminate the trust; and all this action could be taken in shareholders meetings. The court, without any detailed consideration of the point, held that this declaration created a true trust, although it seems fairly clear that under the Massachusetts view this would have been held to be a partnership. A similar case is Smith v. Anderson, where the powers of the certificate holders were not quite so broad but they did have power to fill vacancies in the trustees and approve investments of the trust's funds. This organization was also held to constitute a pure trust.

On the merits the correct result would seem to be somewhere between the extreme positions previously summarized. The test is, or should be, a practical one, but to say that the certificate holders who are mere cestuis should be given the same power as stockholders of a corporation seems subject to the obvious objection that a trust is quite different from a corporation and that the trustees must, in the nature of things, have greater and more exclusive power than corporate directors. No doubt there is a certain similarity in the offices, but the directors are ultimately under the control of the stockholders by reason of the fact that they are elected by them, whereas the cestuis of a trust probably cannot thus control the trustees. The author is inclined to agree, however, that to prevent the certificate-holders taking such action as they may properly be given power to take, in meetings, is carrying the requirement of non-association to a ridiculous extreme. It would seem that association for doing something which is far short of any control whatever of the trustees is hardly sufficient to constitute a partnership.
At any rate the decided weight of authority tends to follow the rigid Massachusetts rule on this point.\textsuperscript{26} And the rule has likewise been approved by the Federal Supreme Court.\textsuperscript{27} It is apparent, therefore, that as a practical matter the certificate holders should be given no power to fill vacancies in the trustees or to remove trustees and that it is not very safe to have any provision for meetings of the certificate holders.\textsuperscript{28}

On the other hand, as has been said,\textsuperscript{29} some courts have contended that a Massachusetts trust, although avoiding the pitfalls of partnership, in fact constitutes a corporation. This seems an obviously fallacious theory, because it ignores the fact that a trust may carry on business as well as a partnership,\textsuperscript{30} and unsound in practice because it requires the difficult if not impossible determination of the line between investment and business.\textsuperscript{31} A trust, in the nature of things, cannot constitute an entity, being merely a method by which certain individuals (the trustees) hold property and carry on activities for the benefit of the cestuis; whereas it is fundamental that a corporation is an

\textsuperscript{26}Reilly\textsuperscript{\textsuperscript{\textsuperscript{v.}}\textsuperscript{\textsuperscript{\textsuperscript{Clyne}, 23 Ariz. 432, 234 Pac. 35 (1925); Betts\textsuperscript{\textsuperscript{v.}}\textsuperscript{\textsuperscript{Hackathorn, 159 Ark. 621, 252 S. W. 602 (1923); Spotswood\textsuperscript{\textsuperscript{v.}}\textsuperscript{\textsuperscript{Morris, 12 Ida. 360, 85 Pac. 1094 (1906); Hart\textsuperscript{\textsuperscript{v.}}\textsuperscript{\textsuperscript{Seymour, 147 Ill. 598, 35 N. E. 246 (1893); Mallory\textsuperscript{\textsuperscript{v.}}\textsuperscript{\textsuperscript{Russell, 71 Ia. 63, 32 N. W. 102 (1887); Hamilton\textsuperscript{\textsuperscript{v.}}\textsuperscript{\textsuperscript{Young, 116 Kans. 128, 225 Pac. 1045; Rand\textsuperscript{\textsuperscript{v.}}\textsuperscript{\textsuperscript{Morse, 289 Fed. 839 (1923) (Law of Missouri involved); Gordon Campbell Petroleum Co. v. Gordon Campbell-Kevin Syndicate, 75 Mont. 261, 242 Pac. 540 (1926); Simson v. K lipstein, 262 Fed. 823 (1920) (Law of New Jersey involved); Appeal of Merchant's Fund. Association, 136 Pa. 43, 20 Atl. 527 (1890); Davis v. Hudgins, 225 S. W. 73 (Tex. Civ. App. 1920). In Home Lumber Co. v. Hopkins, 107 Kans. 158, 190 Pac. 601 (1920) the share holders had the power to hold meetings and elect the trustees, who, however, had the sole power to conduct the business. The court held that this was a true trust, but approved the doctrine of the Massachusetts cases and purported to follow them.\textsuperscript{27}Crocker v. Malley, 249 U. S. 223 (1919); Hecht v. Malley, 265 U. S. 144 (1924).\textsuperscript{28}The contention has sometimes been made that the proper distinction between a trust and a partnership is not one of control but rather of powers; i. e., that a trust cannot carry on business, as distinguished from investment. See W. W. Cook, "The Mysterious Massachusetts Trust," 9 American Bar Association Journal 763. This suggestion appears to be without any support in principle or authority, and may be dismissed without further comment.\textsuperscript{29}See p. 598.\textsuperscript{30}See note 28; also Bouchard v. First People's Trust, supra, note 19, and Betts v. Hackathorn, supra, note 26, both of which are examples of trusts carrying on active business.\textsuperscript{31}See p. 597.
entity. Most of the cases cited on this point relate to Blue Sky Laws, a matter which will be considered hereafter.\textsuperscript{32} Here it is sufficient to notice that the courts often rely upon a constitutional provision which is usually wholly inapplicable to trusts (because the constitutional provisions refer only to "associations") and is certainly by its terms inapplicable except for its particular purposes.\textsuperscript{33} Accordingly, even if the court should be right in saying that the trust is a corporation with respect to the particular matters under consideration, it is certainly unjustified in saying that it is a corporation for all purposes.

A very curious application of this corporation difficulty came in the case of \textit{Superior Oil and Refining Syndicate, Limited v. Handley}.\textsuperscript{34} Here a Massachusetts trust, which was apparently one in the strict sense and in no sense a partnership, carried on the business of making brick and refining oil. This trust was held to be a trust company and therefore within the Oregon laws for regulating foreign banking corporations. It is rather difficult to comment upon this except to say that one would have thought it an impossible decision of any court or other human instrumentality except one devised by the brilliant imagination of a Lewis Carroll or a W. S. Gilbert. The trust company making bricks and refining oil in solemn compliance with the Oregon banking laws is certainly a conception which would have delighted these masters of the grotesque.

It is therefore to be hoped that the corporation theory of Massachusetts trusts will be done away with, as it has no excuse for being. On the other hand the contention of many courts that such a trust so called may very easily become a partnership is entirely sound, even though their application of the distinction may sometimes be subject to criticism.

\textbf{LEGALITY OF THE MASSACHUSETTS TRUSTS}

It would seem that the legality of such a business trust is entirely clear and should be undisputed. Such, however, is not the case, although the authorities are comparatively few which

\textsuperscript{32} See p. 614.

\textsuperscript{33} A typical provision of this sort is Art. 12, sec. 6 of the Kansas Constitution, which was considered in \textit{Home Lumber Co. v. Hopkins}, \textit{supra}, note 26. This provides in part that "The term 'corporations' as used in this article, shall include all associations and joint-stock companies having powers and privileges not possessed by individuals or partnerships." It will be noted that this has no application to trusts, unless trusts are associations; and, of course, they are not.

\textsuperscript{34} 99 Ore. 146, 195 Pac. 159 (1921).
squarely decide that the Massachusetts trust is, by its nature, illegal. But such authorities as decide that a Massachusetts trust is invariably a corporation or a partnership obviously result in effect in denying legality to such a trust, since they deny its only reason for existence. Similarly there are a number of statements unfavorable to the validity of such trusts in connection with state Blue Sky Laws and laws regulating the status of foreign corporations. Conceding that all these are mere dicta, yet they often represent the law of the state on the point or at least the only available evidence of that law. On the other hand, a number of courts which have said and even decided that a Massachusetts trust is illegal in the state have yet recognized its existence in case of a controversy in which the state was not concerned. It follows that an attempt to determine the validity of the Massachusetts trust in the various states is perhaps necessarily unsatisfactory. However, so far as can be determined, the situation is as follows:

The Massachusetts trust is legal not only in Massachusetts, Oklahoma and Wisconsin, which have statutes regulating it, but in Arizona, Arkansas, California, Colorado, Idaho, Illinois, Maryland, Missouri, Montana, New Jersey, New

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35 See for example the Washington cases cited in note 60 below.
36 See Liquid Carbonic Co. v. Sullivan, 103 Okla. 78, 229 Pac. 561 (1924).
37 See Baker v. Stern, 216 N. W. 147.
40 Ex parte Girard, 186 Cal. 718, 200 Pac. 593 (1921).
41 Wimer & Co. v. Downs, 77 Colo. 377, 237 Pac. 155 (1925). Here the question was as to the right to compel transfers, and the validity of the trust was rather assumed than discussed.
44 Warburton v. Perkins, 150 Md. 304, 133 Atl. 141 (1926).
45 State v. Lee, 288 Mo. 679, 233 S. W. 20 (1921). This case holds that a business trust is not a corporation, notwithstanding a provision in the state constitution similar to that of Kansas, set forth in note 33, supra. See also Rand v. Morse, supra, note 26.
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York, 48 North Dakota, 49 Pennsylvania, 50 Rhode Island, 51 and West Virginia; 52 also in England. On the other hand it is apparently invalid in Florida, 64 Indiana, 55 Kansas, 56 Michigan, 57 Oregon, 58 Texas, 59 and Washington. 60 The comments which

in the Federal courts of the same name and involving the same trust is reported in 262 Fed. 823 (1920), supra, note 26.

51 Rhode Island Hospital Trust Co. v. Copeland, supra, note 23.
52 See Marchulonis v. Adams, 97 W. Va. 517, 125 S. E. 230 (1924)

where the court adopted the Massachusetts test with apparent approval; but the case is not really a square decision on the point, since the trust in question was formed in Massachusetts, and the court considered itself bound by the Massachusetts law.

54 Willey v. W. J. Hodgson Corporation, 90 Fla. 343, 106 So. 408 (1925).

See discussion of this case in 3 Indiana Law Journal 318.
56 Home Lumber Co. v. Hopkins, supra, note 26. The court held that a Massachusetts trust could not carry on business in the state, but, on rehearing, concluded that it might sell its securities, upon complying with the local Blue Sky Law. The logic of this conclusion is rather difficult to see, since if the trust is illegal, it would seem hardly proper to permit its securities to be sold.

57 Hemphill v. Orloff, 238 Mich. 508, 213 N. W. 867 (1927). But in Forgan v. Mackie, 232 Mich. 476, 205 N. W. 600 (1925) it was held that a trust formed in Massachusetts could sue in Michigan by its assumed name.


59 The Texas cases on this point are numerous and irreconcilable. Presumably the point was settled by the decision of the state Supreme Court in Thompson v. Schmitt, 274 S. W. 554 (1925), which holds that a Massachusetts trust is invariably a partnership in Texas and overrules Connally v. Lyons, 82 Tex. 664, 18 S. W. 799 (1891). The reasoning of the court is hopelessly bad, especially in the total misunderstanding of the elementary principles of the law of agency. Still it might be supposed to settle the law of the state. But the Commission of Appeals, in Shelton v. Montoya Oil & Gas Co., 292 S. W. 165 (1927), in effect refused to follow Thompson v. Schmitt, so that the very wealth of authority in Texas seems to leave the exact state of the law in greater uncertainty. For other typical cases on both sides of the question see Davis v. Hudgkins, 295 S. W. 73 (1920); Wells v. Mackay Telegraph-Cable Co., 239 S. W. 1001 (1922); McCamey v. Hollister Oil Co., 241 S. W. 689 (1922), affirmed in 274 S. W. 562 (1925); Morehead v. Greenville Exchange National Bank, 243 S. W. 546 (1923); Phoenix Oil Co. v. McLaren, 244 S. W. 830 (1922); Hardee v. Adams Oil Association, 254 S. W. 602 (1923); Graham v. Omar Gasoline Co., 253 S. W. 896 (1923); Cattle Raisers' Loan Co. v. Sutton, 271 S. W. 233 (1925); Continental Supply Co. v. Adams, 272 S. W. 325 (1925);
have been made as to the unsatisfactory nature of the existing judicial pronouncements apply in great force to several of the states listed above as making the Massachusetts trust invalid and it is hoped that they will eventually reach an opposite conclusion when the question is more squarely presented. It is also to be noted that practically every state confines certain sorts of businesses to corporations. This is very frequent in the case of railway and public utility activities and may also be extended to banking and insurance. In these cases, of course, a Massachusetts trust cannot carry on such business but this cannot properly be considered a discrimination against these trusts, since individuals are likewise precluded from such activities.

THE APPLICATION OF THE RULE AGAINST PERPETUITIES AND THE RULE AGAINST RESTRAINTS ON ALIENATION, TO MASSACHUSETTS TRUSTS

It has often been considered or at least feared by persons connected with or advising these trusts, that they may violate the rule against perpetuities. Accordingly, it is quite general to provide for their termination within the period defined by the rule or by the statutes of the state. The persons whose lives are used are often children of persons active in the trust, in

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60 People ex rel. Range v. Hinkle, 126 Wash. 581, 219 Pac. 41 (1923); State v. Paine, 137 Wash. 566, 243 Pac. 2 (1926). But other cases recognize the existence, if not the legality, of business trusts, in Washington. Thus in Jesseph v. Carroll, 126 Wash. 661, 219 Pac. 429 (1923) a mortgage made by such a trust was enforced, and in Lowman v. Guie, 130 Wash. 606, 228 Pac. 845 (1924) the trust was protected as a purchaser of machinery not subject to an unrecorded chattel mortgage. The trustees of a business trust may sue to protect the trust property. Denny v. Cascade Platinum Co., 133 Wash. 436, 232 Pac. 409 (1925); Elsom v. Tefft, 140 Wash. 586, 250 Pac. 346 (1926). Both of the cases last cited insist that a business trust is not an "entity"—a position which is obviously correct but shows the unsoundness of the court's own theory that such trusts are analogous to corporations or associations. It is also held that the existence and validity of business trusts are not subject to collateral attack, but only to direct attack by the state. Haynes v. Central Business Property Co., 140 Wash. 596, 249 Pac. 1057 (1926).

61 See for examples, Burns Annotated Indiana Statutes (1926), Sec. 8877 (insurance) and Sec. 12858 (railroads).
order that the period may be as long as possible. Probably such a provision is desirable, as a matter of precaution. But it is submitted that the rule against perpetuities has no relation whatever to a Massachusetts trust—as indeed it has not to any other trust. The rule is, by its very definition, concerned with non-vested interests only. The interest of a holder of a certificate of beneficial interest is clearly vested. It is to be sure a limited and equitable interest but it is as fully vested as a legal fee simple. Fortunately this point seems to have given the courts little trouble.

The same applies to the rule against restraints on alienation. The intention, at least, is to make the certificates as nearly negotiable instruments as shares of stock of corporations. While stock certificates are not strictly negotiable instruments, no one has ever doubted their transferability. It might be urged that these certificates of beneficial interest in a trust ordinarily represent real estate and that might create some difficulties in transferring them. This matter will be discussed more fully in connection with the subject of taxation. It is sufficient to say here, first, that such certificates are ordinarily transferable only by written indorsement (which satisfies the Statute of Frauds) and secondly that the real property of the trust is generally converted by agreement into personal property. In any case, beneficial interests, while limited, are as fully transferable as any interests whatever. It is also quite usual to provide that the trustees shall have power to convey the trust property; but it seems clear that they have this power, anyway, unless specifically restricted.

THE TAX LIABILITY OF MASSACHUSETTS TRUSTS, AND OF THE PERSONS INTERESTED IN THEM

It is obvious that a Massachusetts trust (which is a real trust) cannot be subjected to taxes imposed on a partnership or upon partners. On the other hand there has been some attempt to impose corporation taxes upon these organizations. This seems a manifest absurdity until it is understood that joint stock

64 Baker v. Stern, supra, note 37, also considers the rule against restraints on alienation and correctly decides that it has no reference to the beneficial interests in trusts.
associations and similar organizations, while technically partnerships, are frequently treated as corporations, for tax purposes. This has been the rule of the federal government with respect to income taxes from the beginning; and the Supreme Judicial Court of Massachusetts has reached the same conclusion with respect to the power of the legislature to tax such unincorporated organizations. Indeed a number of cases in which the nature of the organization—that is whether joint stock association and therefore partnership, or true trust—was determined, were tax cases.

The test with respect to income tax liability is very similar, as has already been pointed out. In the federal law it is specifically provided that “The term ‘corporation’ includes associations, joint stock companies, and insurance companies” and of course that such “corporations” are themselves subject to income tax. The same was true with respect to the excess profits tax imposed under the Revenue Acts of 1917, 1918, and 1921. On the other hand, it is obvious that a true trust is not an entity and cannot be subjected to income or other taxes as such. This does not mean of course that income from trust property is non-taxable nor would it perhaps be impossible to impose an excise tax upon merely acting in a trust capacity. But it is clear that all such taxes must be imposed upon individuals or other taxable entities—the trustees or the cestuis, or both—but cannot be imposed upon the trust itself. This is not a mere technical distinction, for while under the Federal Revenue Act, a tax is of course imposed upon income from trust property, the tax is at the regular rates of taxes upon individuals even when, as a matter of procedure, it is collected from the trustees. This is the usual procedure but it is provided that in the case of trust income which may in the discretion of the fiduciary be distributed to the beneficiaries the amount actually so distributed need not be accounted for by the trustees but constitutes part of the taxable income of the beneficiaries. This provision would apply to the trusts under consideration so that with respect to actual distributions during the year no tax would be imposed upon the trust or trustees, but the tax would be paid by the

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67 For example, Williams v. Milton, supra, note 14.
68 Sec. 2 of the Revenue Act of 1926. This 1926 Act will be referred to hereafter in connection with Federal taxation unless specifically otherwise provided.
69 Sec. 219, especially subdivision (b) (2).
beneficiaries exactly as if the trust did not exist. It may be added that the tax authorities have tended to look with great hostility upon trusts formed by one individual or by a small group of wealthy individuals with the hope of so manipulating their income as to escape tax thereon; and such feeling is hardly unnatural. But this can hardly apply to the average Massachusetts trust where the number of beneficiaries is so large as to preclude any effective jockeying of the income between the trust and themselves.

The above represents what is clearly the situation under the Federal Income Tax Law and indeed, as already shown, it is impossible, in the nature of things, to impose an income tax upon a trust as such. The United States Supreme Court adopted this view in Crocker v. Malley, where the court having reached the conclusion that the trust there in question was a true trust within the test of the Massachusetts cases, found no difficulty in holding that it was not subject to income tax. The more recent case of Burke-Waggoner Oil Association v. Hopkins is not in any respect contrary, for here the alleged trust was found to constitute a partnership. It is probable that this conclusion was correct even under the Massachusetts view because of the large measure of control which the certificate holders had. At any rate, the court considered that it was bound by the law of Texas, where the trust was organized, which, as already indicated, would seem to hold that all business trusts are partnerships.

The same rule would apply to excise taxes, at least in the absence of a special excise tax imposed upon individuals doing business in a trust form. Even then the tax could not be imposed upon the trust itself, and as a matter of fact no such tax is imposed. Indeed, the early cases under the corporation excise tax act of 1909 held that even partnership associations could not be subjected to tax, by reason of the fact that they were not organized in pursuance of a statute. But the well known case of Hecht v. Malley was deemed to throw considerable doubt

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70 Cf., however, Weeks v. Sibley, supra, note 9.
71 Supra, note 27.
72 269 U. S. 110 (1925). Chicago Title & Trust Co. v. Smietanka, 275 Fed. 60 (1921) is a similar case.
73 Flint v. Stone-Tracy Co., 220 U. S. 107 (1911); Eliot v. Freeman, 220 U. S. 178 (1911). But in Robertson v. Anderson, 226 Fed. 7 (1915) a New York joint-stock association was held subject to the tax, because it was organized under, and given special powers by, a state statute, although the liability of the members was unlimited.
74 Supra, note 27.
upon the proposition that Massachusetts trusts are not subject to excise taxes. Indeed this case has been claimed to overrule *Crocker v. Malley,* although the court itself indicates that its conclusion might well be different with respect to income taxes.

The Hecht case involved the question as to the liability to the federal excise tax (called the “Capital Stock Tax” because based upon the fair value of the capital stock) imposed by the Revenue Acts of 1916 to 1924. This tax was imposed upon corporations, associations, etc., “with respect to carrying on or doing business” and of course did not apply even to corporations in the strict sense, which did not carry on business. Obviously, however, this restriction does not apply to Massachusetts trusts, for they certainly do carry on business. The only question is whether they are associations, and so taxable entities. The case involved three such trusts, one of which had been reorganized as an association. The court concluded that all three were associations and so taxable under the 1918 act though not taxable under the 1916 act because in the court’s opinion the 1916 act had carried over the same restrictions as the 1909 act—that only associations organized in pursuance of a statute should be taxable. The 1918 act had no such restriction.

So far, no criticism can be made of the decision of the court and the contention that it overruled *Crocker v. Malley* is an obvious absurdity, in view of the fact that all of the so-called trusts in the Hecht case were, in the opinion of the court, taxable entities. It must be conceded however that the court did add by way of dictum certain language which does throw real doubt upon *Crocker v. Malley* and the view as to the non-liability of Massachusetts trusts to tax, hereinbefore expressed. There is more or less language that a Massachusetts trust is subject to excise tax because it carries on business in a similar manner and with similar immunities to the persons concerned, as a corporation. Such language is most unfortunate in that it has given rise to a misconception of what the case actually decided. It is confidently hoped that when the question again comes before the court, it will recognize that such language is pure dictum and that *Hecht v. Malley* does not and could not properly decide

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73 Supra, note 27.
76 The contention that *Hecht v. Malley* overrules *Crocker v. Malley* is made in *State v. Paine,* supra, note 60.
77 See cases cited in note 73, supra.
78 This is clearly shown by the decision in *Hornblower v. White,* 21 F. (2d) 82 (1927).
that a Massachusetts trust (which is a true trust) can be subject to an excise or other tax.

The rule with respect to stock issue taxes must be essentially the same. This is not solely because the interest of a certificate holder of a trust is not stock—this is perhaps a purely technical distinction—but because such a tax is imposed upon the issuing organization, and a trust as such is not taxable. The single authority is in accord with this contention.\(^7\) On the other hand it might well be contended that a transfer of certificates of beneficial interests in a trust might be taxed because this would be a tax which would ultimately fall upon individuals; but no such tax is imposed at present.

The question still remains as to property and inheritance taxes. Neither can be imposed upon a trust as such, but so far as property taxes are concerned, the practical difficulty is not very great, because the tax may be (and generally is) imposed upon the trustees and so is paid out of the corpus of the trust. It would appear that to impose a tax upon the cestuis with respect to their beneficial interests in the trust would constitute double taxation. But where the property is outside the state or where the certificate holder is a non-resident there is no problem of double taxation, so far as a single jurisdiction is concerned, at least, and the question of the nature of the certificate holder's interest becomes vital. At the same time if the certificates represent real property their transfer may involve serious legal difficulties. The undoubted economic similarity between such trust certificates and corporate stock certificates breaks down at this point.

It seems fairly obvious that beneficial interests in a trust which holds real estate outside of the jurisdiction are not subject to tax in the jurisdiction in the absence of some provision in the trust instrument showing an intent for the equitable conversion of the realty into personal property.\(^8\) But such a provision is quite common in the declarations used for business trusts. Indeed it is often provided specifically that the shares are to be regarded as personal property. Under these circumstances the transferability of the certificate seems clear, but the liability of the interests represented by the certificate to taxation as personal property at the domicile of the holder seems likewise unescapable.\(^8\)

\(^7\) Hornblower v. White, supra, note 78.
\(^8\) Green County v. Smith, 148 Ark. 33, 228 S. W. 730 (1921).
\(^8\) See Rice v. Rockefeller, 134 N. Y. 174, 31 N. E. 907 (1892).
The matter has been elaborately considered by the Supreme Judicial Court of Massachusetts in two cases, Dana v. Treasurer and Receiver General and Priestly v. Burrill. In the Dana case there were three so-called trusts, but two of them were determined by the court to constitute partnerships. All three owned real property outside Massachusetts. The question arose as to the liability to inheritance tax of beneficial interests in these trusts owned by a resident decedent (the question as to liability to property tax, although not litigated, would seem to be the same). The court held that the interests in the first two so-called trusts (but actually partnerships) were taxable. The decedent's interest was that of a partner and while in Massachusetts (as in most American jurisdictions) the mere fact of partnership does not of itself constitute a sufficient reason for determining that the property has been converted, yet the court considered that the provisions in the agreement for future conversion and for the present transferability of shares showed that a conversion was intended. It may be questioned whether these provisions were necessarily sufficient to prove an intent to convert, but certainly no very great evidence of such intent is necessary in the case of a partner. With respect to the final trust, which the court held really was a trust, the court reached the conclusion that the beneficial interest was non-taxable. There was no provision for conversion here and the court held that a mere provision that the certificates of beneficial interest should be transferable was not sufficient to show an equitable conversion, since a writing would satisfy the Statute of Frauds. It would appear from this that a bearer certificate of interest in a Massachusetts trust would have to be treated as personal property because it is transferable without writing and so if it represents real property it violates the Statute of Frauds. Furthermore what is to be said of statutes which require that a conveyance of real property be under seal? It might be answered that such statutes do not refer to equitable interests since equity contrary decision of Bartlett v. Gill, 221 Fed. 476 (1915) seems unsustainable, and is, in fact, disapproved in the Massachusetts cases, hereafter discussed. In Kennedy v. Hodges, 215 Mass. 112, 102 N. E. 432 (1913) the court said with respect to the transferability of certificates in a business trust "There is on principle in this respect no distinction between such certificate and a certificate for shares of stock in a domestic corporation."

83 230 Mass. 452, 120 N. E. 100 (1918).
will supply this defect in an otherwise proper conveyance.\footnote{See Pomeroy’s Equity Jurisprudence, Sec. 70.} It is submitted that in the normal case and even without an express provision in the Declaration of Trust to this effect the certificates of interest in a Massachusetts trust holding real property must be deemed to represent personal property, since they are obviously intended to be transferable as freely as corporate stock certificates and if they represent real property the transfer is certainly more difficult, and its validity more doubtful.

*Priestly v. Burrill*\footnote{See note 83, supra.} is to some extent a converse case. Here the intestate was a non-resident of Massachusetts but owned interests in several so-called trusts holding real property in that commonwealth. In the first of these trusts there was a specific direction in the trust agreement that the trustees should convert the real property into personalty. The court held therefore that the interests of the intestate in these two trusts constituted personalty and was non-taxable in Massachusetts. It may be noted that the court does not make it clear as to whether, in its opinion, these two trusts were actually trusts or not, and indeed intimates that under the circumstances this would be immaterial. As to the third so-called trust, it was held to be in fact a partnership, and there being no requirement for conversion, the intestate, though a partner, was held the owner of an interest in real property in Massachusetts, and an inheritance tax imposed.

This case certainly does not tend to change the conclusion tentatively drawn from the previous case, at least with respect to the normal situation. The certificates of interest in a Massachusetts trust are freely transferable, with no greater formality than is required in the case of corporate stock certificates; but for that very reason, such certificates represent and constitute personal property and are subject to tax at the domicile of the owner, even though some or all of the property of the trust consists of real estate outside of the state of domicile. To make the certificate transferable as freely as corporate stock certificates it is generally necessary to consider that this real estate is converted into personal property.\footnote{However, in *Baker v. Commissioner of Taxation*, 253 Mass. 130, 148 N. E. 593 (1925) it was held that the certificates represented an equitable interest in real property. The case is perhaps reconcilable with the view herein expressed, because the express provision in the Declaration of Trust for future conversion might reasonably be considered to exclude a present conversion.}
LIABILITY TO STATE BLUE SKY LAWS

That Massachusetts trusts should be subject to the so-called Blue Sky Laws of the states where they respectively operate, seems fairly obvious. Whether such laws perform any useful function is to say the least somewhat questionable, but that their scope comprehends the business trust is entirely clear. The Massachusetts trust carries on active business and, what is more to the purpose with respect to Blue Sky Laws, it generally attempts to distribute its securities somewhat widely. Under these circumstances although the trust is not a corporation or an association, it would clearly be a serious defect in the application of the Blue Sky Laws if they did not include such trusts which constitute an increasingly popular method of doing business and selling securities. It is hardly surprising, therefore, to find that the authorities are unanimously to the effect that business trusts must comply with the Blue Sky Laws of the state in order to be permitted to distribute their securities within the state.\(^8\) In some states, as in California,\(^8\) this result is entirely clear, since the Blue Sky Law specifically includes individuals as well as corporations and associations. Undoubtedly this is the most desirable form of such a statute. But states where the statute is more restricted in its application have by some method of construction managed to stretch the statutory language so as to make it cover the Massachusetts trust.\(^8\) In some cases as in Kansas\(^8\) this necessitates treating the trust as an association, which is clearly wrong, but perhaps does not work so badly for this particular purpose. It would appear that the holdings


\(^8\) *Ex parte Girard*, supra, note 40; *Agnew v. Daugherty*, 189 Cal. 446, 209 Pac. 34 (1922).

\(^8\) *Reilly v. Cline*, supra, note 26; *Coleman v. McKee*, 162 Ark. 90, 257 S. W. 733 (1924) (holding that securities of a Texas trust may be sold in Arkansas, upon complying with the statutory formalities, since, whatever their validity in Texas, they were valid in Arkansas); *King v. Commonwealth*, 197 Ky. 128, 246 S. W. 162 (1922); *Wagner v. Kelso*, 195 Ia. 959, 193 N. W. 1 (1923); *People v. Clum*, 213 Mich. 651, 182 N. W. 136 (1921); *State v. Summerland*, 150 Minn. 266, 185 N. W. 255 (1921); *Schmidt v. Stortz*, 208 Mo. App. 439, 236 S. W. 694 (1922).

of the courts on this point are substantially sound although they are sometimes based upon a rather unjustified stretching of the statutory language, which has its unfortunate effect in other connections, as has already been seen. But the net result is that the Massachusetts trusts are subject to the state Blue Sky Laws and it is rather hard for the most enthusiastic defender of these trusts and especially of their freedom from undue governmental interference, to deny that such holdings are justified.

POWER OF THE STATE TO EXCLUDE MASSACHUSETTS TRUSTS FROM DOING BUSINESS

This topic is obviously closely related to that of the Blue Sky Laws. It would seem that if the states can subject these trusts to their Blue Sky Laws, they could likewise exclude such trusts if they failed to comply therewith; and indeed this is indisputable. However, the broad question remains as to the right of the states to exclude Massachusetts trusts altogether. Here again it would seem entirely proper, as a matter of policy, that the states should have this power; and so it has been held. The leading case is Hemphill v. Orloff, but it is submitted that the reasoning of the case is hardly satisfactory. It proceeds upon the assumption, which is entirely unjustifiable, that in fact the Massachusetts trust is a corporation or at least an association and is therefore without inherent right to carry on business in the state. Upon this assumption the argument of the court proceeds easily to the result desired.

But the reasoning of the court amounts to nothing more than the setting up of a man of straw—to wit the alleged claim of corporate immunity from state regulation—and knocking it over. The decision leaves untouched the very serious constitutional question which arises because of the actual nature of the Massachusetts trust. Not only does the federal constitution prevent a state from barring an individual from doing business within its borders but it has likewise been held that a state statute prohibiting a non-resident from acting as trustee of property within the state denied such person his constitutional

91 See cases cited in notes 87 to 89, supra.
92 Supra, note 57. See discussion of this case in 41 Harvard Law Review, 86. The Washington rule is likewise to the effect that a Massachusetts trust may be excluded from the state. People ex rel. Range v. Hinkle, supra, note 60; State v. Paine, idem (but see Haynes v. Central Business Property Co., idem).
By combining these two doctrines, the argument that a Massachusetts trust cannot be excluded by a state, can be made very strong. Such a trust is simply individuals holding property in trust and carrying on business within the state; it is in no sense a corporation or association. Therefore it may well be asked by what possible means the state can claim authority to exclude it?

But this argument proves rather too much. If it is sound, it must follow that the state has no regulatory power whatsoever and that even Blue Sky Laws do not apply to such trusts. Such a situation would obviously be intolerable and would lead to the speedy suppression of all such trusts. It has also been suggested that a state may declare such trusts to be contrary to its policy and thus prohibit them from any activity in the state or restrict their activities upon any desired terms. This argument is probably sound although it too may be considered to prove too much, for if a business trust is contrary to the policy of the state then all trusts (or at least all trusts where the trustees have any power whatever to carry on business activities) must likewise be considered as contrary to the policy of the state. And no state would adopt such a far reaching policy as this.

But the demand of policy that business organizations of any substantial size and capitalization and particularly those having numerous and widely-distributed share holders, should be under state supervision seems to compel an affirmative answer to the question as to the state's power to exclude Massachusetts trusts. As already indicated, the constitutional question is still open and on pure logic a very strong argument can be made in favor of the entire freedom from interference of such trusts. It is believed, however, that when the question is squarely presented to the Federal Courts, they will reach the conclusion that the

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94 Farmers Loan & Trust Co. v. Chicago & Alton Ry. Co., 27 Fed. 146, and Shirk v. LaFayette, 52 Fed. 857, both holding unconstitutional an Indiana statute providing that only citizens of the state could act as trustees for holding real estate within Indiana. The doctrine of these cases was accepted by the Indiana Supreme Court in Roby v. Smith, 131 Ind. 342, 30 N. E. 1093 (1892).

95 Reilly v. Cline, supra, note 26, is also in error on this point.

96 See 41 Harvard Law Review 86 (supra, note 92.)

97 Testamentary trusts are legal everywhere, and that they carry on business is immaterial. See p. 597.

98 An attempt to raise the point in connection with the Washington doctrine proved abortive. Taylor v. Dunbar, 298 Fed. 936 (1924).
power of the Massachusetts trusts to carry on business within
the states and the terms on which such business is to be con-
ducted are and should be within the power of the states, so long
as no improper discriminations, of a nature which would in-
valida corporation restrictions, are imposed.

THE BANKRUPTCY ACT

The question of the liability of a business trust to be
adjudicated a bankrupt has arisen in a number of cases. Of
course if it constitutes a partnership it is clearly within section
23 of the Act,99 but, as already shown, a true Massachusetts
trust is not a partnership. Indeed the comparatively early case
of In re Associated Trust,100 in discussing this question reaches
the conclusion that while the organization in question was not
a true trust neither was it a partnership. The court then
reached the somewhat surprising result that a business trust
is an “unincorporated company” within Sec. 22 of the Act.
From this decision nearly all the authority on the point seems
to have descended. There are therefore a considerable number
of decisions laying down broadly the proposition that a Massa-
chusetts trust is subject to be adjudicated a bankrupt, as an
unincorporated company.101 Some of the decisions plainly re-
late to an organization which was a trust only in name,102 but
others deal with what are apparently trusts in the strict sense.

Logically, this result is an absurdity. A Massachusetts trust
is certainly unincorporated, but it most decidedly is not a “com-
pany”, a term which at least denotes an association, if not a
legal entity. Nevertheless the result is not so seriously
objectionable from the practical standpoint, nor is it perhaps
so far from the intent of the framers of the bankruptcy act.

It seems fairly clear that this intent was to cover any bus-
ness organization treated by common consent and from the
economic standpoint as a unit. This might perhaps have been
fully accomplished by a provision for individuals, corporations

100 222 Fed. 1012 (1914).
101 In re Sargent Lumber Co., 287 Fed. 154 (1923); Krey Packing Co.
v. Wildwood Springs Resort Association, 4 F. (2d) 793 (1925). See also
In re Order of Sparta, 242 Fed. 235 (1917) and In re Tidewater Coal
reversing 275 Fed. 888.
102 E. g. In re Tidewater Coal Exchange, supra, note 101.
and partnerships, since the latter term includes, or may include, joint stock associations and similar organizations;\(^{103}\) but to make assurance doubly sure, the provision for unincorporated companies was added. The action of a court in disregarding the primary meaning of words in a statute, merely because the statutory language does not cover a situation not foreseen by the legislature, upon the theory that the legislature would have provided for it if it had foreseen it, is of course not generally to be commended; and it is clear likewise that most of the cases on this point are a mere restatement of the ill-considered dicta, in *In Re Associated Trust.*\(^{104}\) Nevertheless the result is more objectionable from a theoretical than from a practical standpoint and it is improbable that the federal courts will now change the thus far practically unanimous rule on this point, that a Massachusetts trust may be adjudicated bankrupt.

**LIMITATION OF THE LIABILITY OF PERSONS CONNECTED WITH MASSACHUSETTS TRUSTS**

The primary purpose of the formation of a business trust is to obtain the limitation of liability of the persons connected with it—both trustees and *cestuis*—without the formation of a corporation. The legal aspects of this matter have already been fully discussed in a comment in this publication,\(^{103}\) so that an extended discussion of this point seems now unnecessary. To summarize the situation, it seems clear that if the legality of a Massachusetts trust is recognized at all, the contractual liability of the *cestuis*, being purely secondary, can be limited or entirely abrogated by a provision in the contract or in the trust instrument. Courts which deny this must thereby deny the entire legality of a Massachusetts trust. Since the trustees are primarily liable it is not possible to impose a limit upon their liability except by a specific provision to that effect in the contract or trust agreement, which provision must be brought to the notice of the creditor who is claimed to be bound thereby. Some courts deny that such a provision is legal but the distinct weight of authority and reason is to the effect that the contractual lia-

\(^{103}\) See p. 608.

\(^{104}\) *Supra,* note 100.

\(^{105}\) 3 Indiana Law Journal 318. Since the publication of this comment, the matter has been exhaustively considered by the Illinois Supreme Court in *Schumann-Heink v. Folsom,* *supra,* note 43, and the conclusions set forth in the comment and in this article are fully supported by that decision.
bility of the trustees may thus be limited, since the creditor has recourse to the trust fund.

As to tort liability, it seems clear that the trustees cannot be absolved from personal responsibility, although they are of course entitled to indemnity from the trust fund except for torts for which they were personally to blame. The *cestuis* are generally held not to be liable for torts of the trustees in which they do not personally participate, at least where the trustees have not a claim for indemnity against the trust. Indubitably this may impose a hardship upon the tort creditor, and it has been forcibly urged that such liability should be imposed upon the *cestuis* irrespective of the financial relations between the trustee and the *cestuis*.\(^{106}\)

In the comment above referred to, it was also pointed out that limitations of contractual liability were possible to some degree even in the case of partnerships and that there was much to be said for enforcing a provision for such limited liability against a creditor of an organization purporting to be a trust but later determined by the court to constitute a partnership association because of the control exercised by the so-called *cestuis* upon the trustees. This is a matter outside the scope of this article, which is intended to deal with the Massachusetts trust in the strict sense of that term. It is appropriate, however, to notice a further objection which has been made by certain courts to the recognition of Massachusetts trusts, particularly with respect to clauses limiting liability of the *cestuis* and the trustees. This objection is that such trusts violate the policy of the limited partnership statutes which, these courts contend, represent the only legal method, outside of incorporating, for securing limited liability.\(^{107}\)

This argument is perhaps sufficiently answered by the New York case of *Crehan v. Megargee*.\(^{108}\) This case is especially interesting as having arisen in the state where limited partnerships were first authorized in this country and where they have had the fullest development. Here a trust was formed for the purpose of raising funds to be used by the trustee as his contribution to the capital of a limited partnership, of which he was the special partner. The usual provisions were made for

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\(^{107}\) See cases cited in note 92, especially *Hemphill v. Orloff*.

\(^{108}\) *Supra*, note 48.
the conduct of the trust, the only rights of the *cestuis* being to receive a share of the profits coming to the trustee as such special partner. The partnership having become insolvent, its creditors brought suit against all of the *cestuis*, upon the ground that they were liable as general partners because of non-compliance with the statute. The court however dismissed the claim, holding that the *cestuis* had no relation whatever to the partnership, but only to the trust. It stated that the policy of the limited partnership statute was here subserved since the special partner in fact made the contribution stated in the partnership agreement and subjected it to the risks of the business; and that how he had raised this capital, and his obligation with respect to the distribution of the partnership profits, were no concern of the general partners nor of the creditors of the partnership. The creditors were held to have no standing to attach the validity of the trust, to which they were entire strangers.

This case clearly shows that there is no conflict between the limited partnership statutes and Massachusetts trusts. It is true that the limited partnership statutes furnish a means (and perhaps the sole means) of securing the limited liability of a partner; but a limited partnership is still a partnership, with all the partnership incidents except as specifically changed by the statute. On the other hand, as *Crehan v. Megargel* shows, a trust is not a partnership, limited or otherwise, and the partnership statutes and decisions have no relation to such trusts.

**MISCELLANEOUS MATTERS**

The law of corporations gives stockholders certain rights to prevent or control directorate action which might be detrimental to their interests. Among these are certain limited rights of inspection of books, pre-emptive rights to subscribe to new issues of stock, the right to compel the directors to permit the transfer of stock upon the books, and in some very unusual cases the right to remove directors guilty of failure to perform their duty. These rights are of somewhat uncertain scope and therefore frequently somewhat unsatisfactory at common law. They are therefore often regulated by provisions of the certificate of incorporation and the by-laws of the corporation.

There is no certainty, of course, that such rights have any existence at all in the case of *Massachusetts Trusts* as such.111

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This is a question which is not likely to become of great importance, in view of the fact that such matters are generally fully provided for in the declaration of trust. It is desirable, in order to avoid any controversies upon the matter, that full provision be made with respect to all such questions, although, as already shown,\textsuperscript{112} provisions for the removal of the trustees are dangerous because of the possibility that they may lead the trust to be considered a partnership.

But even in the absence of such provisions, the certificate holders are not without remedy. It has been suggested that their lack of control over the trustees is a serious objection to the formation of such trusts in that it gives too great scope to the trustees' action, without responsibility to the security holders.\textsuperscript{113} To this it may be answered that the control of stock holders of directors is very indirect and is not often effective.\textsuperscript{114} An even more pertinent answer is that trustees, as such, are under probably the most rigid liability known. While cestuis cannot control the discretion of the trustees, yet it is elementary that a court of equity will upon application of the cestuis and even upon its own motion penalize trustees with the utmost severity for any action considered by the court to fall short of the standard of due care and of the highest good faith. No provision of the trust instrument can prevent the cestuis from applying to the court for relief. This means that the security holders in a business trust while having perhaps less control over the trustees than the stockholders of a corporation have over its directors, are nevertheless even more fully protected against any improper action by the trustees.\textsuperscript{115} It is submitted that if

\textsuperscript{111} See H. Kramer & Co. v. Cummings, supra, note 43, to the effect that a Massachusetts trust is not subject to the restrictions of the corporation laws.

\textsuperscript{112} See p. 602.


\textsuperscript{114} In Spraker v. Platt, 158 N. Y. App. Div. 167, 143 N. Y. Supp. 440 (1913) provisions in the articles of association which were intended to, and in fact did, insure a self-perpetuating Board of Directors, were upheld. For a good discussion of the similarities and differences between directors and trustees, see In re Faure Electric Accumulator Co., 40 Ch. D. 141 (1888).

\textsuperscript{115} See Burnett v. Smith, 240 S. W. 1007 (Texas, 1922) and Phoenix Oil Co. v. McLarren, supra, note 59, for applications of these principles of trustee liability to the case of Massachusetts trusts. In Maher v. Landreth, 22 F. (2d) 752 (1927), a suit was brought by certain cestuis of a
control by the security holders is a desirable factor in business organizations, the Massachusetts trust furnishes from this aspect a more desirable form of investment than the corporation. Another matter with respect to which there might well be disagreement is as to the liability of the certificate holders to pay up the par amount of their certificates. Ordinarily in the case of corporations this liability is imposed only for the benefit of creditors. But in the case of trusts if no agreement is made to pay in anything additional, it is difficult to see what rights the creditors have.

Indeed such certificates do not ordinarily have par value and it is not contemplated that they shall have any qualities analogous to the par value of stock. The interest of the certificate holder is an interest in the trust assets proportionate to the amount which he has actually paid for his certificate. In other words, the certificate, viewed from the aspect of money equivalent, is rather a receipt for money paid than a promise to pay more.\textsuperscript{116} Nevertheless in \textit{Dunbar v. Broomfield}\textsuperscript{117} it was held that the trustees of an insolvent Massachusetts trust could sue to compel the certificate holders to pay their unpaid subscriptions to an amount necessary to pay the creditors. While this seems a desirable result it is doubtful where it can be sustained at common law, without an express provision in the declaration of trust to this effect, or something from which a contractual liability of the certificate holder to pay a certain additional amount may be inferred.

Another matter which has been considered by several courts is the propriety of investment by fiduciaries in the securities of Massachusetts trusts. It is submitted that for this purpose the trust is to be considered as analogous to a corporation; that is to say, if the securities of a corporation in like financial situation and with similar management would be suitable for investment business trust against the trustee for the purpose of surcharging the trustee with certain losses sustained in the administration of the trust; the court treated the situation exactly as if it had arisen in a non-business trust but disallowed the surcharge because of the finding that the defendant acted in good faith.

\textsuperscript{116} Of course if the certificate holder is indebted to the trust, the creditors may take advantage of the debt. All that is here insisted on, is that there is no obligation, legal or equitable, to pay up an assumed par value of the certificate. See Sears “Trust Estates as Business Companies,” 2d edition, Sec. 171.

\textsuperscript{117} 247 Mass. 372, 142 N. E. 148 (1924).
the trust securities are likewise suitable, and vice-versa. This has usually been the attitude of the courts.\(^{118}\)

One other question, which has received considerable judicial consideration is the purely procedural one of how a Massachusetts trust may sue or be sued. As already shown, it is not an entity and so cannot, at common law, be sued by its collective name. There is of course, no objection to statutes permitting the suit to be brought in the collective name, since even partnerships or associations, and any other body of persons not associated but having a collective name, may thus be sued.\(^{119}\) Massachusetts\(^{120}\) has such a statute and so has Oklahoma.\(^{121}\) Since however the matter is purely procedural it would seem to be governed by the law of the forum. Thus it has been held that a Massachusetts trust could not sue by its collective name in New York although it of course could in Massachusetts where it was formed.\(^{122}\)

Allied with this, is the matter of federal jurisdiction through diversity of citizenship. In this latter question, the turning point is the consideration of who actually sues or is sued when a Massachusetts trust is a party litigant. The answer must obviously be that it is the trustees. They own all of the trust property and are in control of its business. They therefore represent the security holders, who need not join or be joined.\(^{123}\) If all of the trustees are citizens of a different state from the opposite party litigant, the federal court has jurisdiction, notwithstanding the fact that some of the cestuis may be citizens of the same state as the opposing party to the suit.\(^{124}\)


\(^{119}\) United Mine Workers v. Coronado Coal Co., 259 U. S. 344 (1922). A note in 33 Harvard Law Review 298 takes the position that all associations and business trusts (except ordinary partnerships) should be treated as entities for procedural purposes, but even associations are not generally so treated except under the authority of a statute.

\(^{120}\) Bouchard v. First People's Trust, supra, note 19.

\(^{121}\) General American Oil Co. v. Wagoner Oil & Gas Co., 118 Okla. 183, 247 Pac. 99 (1926).


\(^{123}\) Simson v. Klipstein, supra, note 26. See also Simson v. Klipstein, supra, note 47.

\(^{124}\) Village Mills Co. v. Houston Oil Co., 241 S. W. 122 (Texas, 1922).
CONCLUSION

It must be clearly evident from this discussion that the Massachusetts trust has been the subject of widely varying judicial and other authoritative opinion. Some have held it to be the ultimate supplanter of the corporation;\(^{125}\) others as a dangerous interloper into the business world, which should be promptly and completely suppressed by law.\(^{126}\) Neither of these results have come to pass and it seems probable that neither will. Corporations continue to flourish, and so will trusts. For instance in Texas where the courts have been the most hostile to such trusts there are probably a greater number of them organized than in any other state except perhaps Massachusetts itself—unfortunately, for the most part, for the exploitation of oil properties and even more clearly of the unwise persons who invest therein. This indeed might be considered a serious objection to such trusts, were it not for the fact that the duly organized corporations whose stockholders have had similar unfortunate experiences, is legion.

What then is the place and function in the business world of the Massachusetts trust? It certainly furnishes a method, alternatively with the corporation, of providing for the combination of small investments to be managed by fiduciaries in a unitary manner, and with limited liability to the investors. On the other hand, such limited liability can be secured only by contract so that a trust is necessarily a somewhat unwieldy organization for very large businesses. Its distinct advantage is in its greater flexibility. Not only is it not subject to the rigid and often more or less unsatisfactory corporation statutes, but its entire scope and its method of organization may be changed by agreement and without the necessity of filing papers in public offices or obtaining the approval of public officials. This does not really constitute any danger to investors, because of the large scope of judicial control over trusts (including in proper cases even in-


\(^{127}\) This is a protection to the trustees which directors of a corporation can never have, except possibly in a few instances where a declaratory judgment can be obtained. Only a few American jurisdictions have yet
structing the trustees beforehand) and also because of general regulatory statutes, such as Blue Sky Laws, which relate to trusts as well as to corporations. Furthermore the declaration of trust can and should be carefully drawn so as to provide quite fully for all matters which are otherwise likely to give rise to controversy between trustees and cestui que.

It would seem that trusts should not be used in states like Indiana, where their legality and effect is doubtful, until this question is definitely settled, although as shown above the practice in Texas has not been thus conservative. Statutes with respect to business trusts are perfectly proper if they are similar to the present Oklahoma and Massachusetts statutes, which provide for recording the declaration of trust, suits in the trust name, etc.; but they are objectionable if they go much further, as a regulation of such trusts with the particularity frequently encountered in the corporation laws will destroy the chief advantage of the trusts—the attainment of limited liability with freedom from governmental interference in their method of organization, and greater flexibility than in the case of corporations.

With these qualifications kept in mind, it would seem proper to predict that the Massachusetts trust is likely to become an increasingly popular method of doing business, but one which in the nature of things can be only supplementary to, and cannot supplant, the corporate form. The trust will best perform its function in comparatively small businesses where greater flexibility is desirable and where the circumstances permit great personal confidence to be accorded to the trustees. Such confidence is necessary, because there are no public reports required, although as a matter of fact the liability of the trustees is even more stringent than that of directors. The corporation is likely to hold the field still, where the business done is very large, and particularly where it is spread into a number of states. Here the very rigidity of the corporation laws and the requirement of periodical public reports is a valuable protection to the security holders, as well as to creditors. The trust is a method of getting corporation results by agreement, and it has the disadvantage of requiring complete agreement beforehand on all important details. On the other hand there is no possible reason

provided for a declaratory judgment and it is doubtful whether such statutes, even when enacted, will have much effect in intra-corporation difficulties.

128 See p. 596.
for the state to object to the doing of business on such terms, when it is practically possible, and it is believed that all jurisdictions will eventually reach this sensible conclusion. When that happens, corporations and trusts will both have a proper place in the general business organization and both in their own sphere will perform useful functions.