ANTI TRUSTS: REFORMING AN EXCESSIVELY FLEXIBLE LEGAL TOOL

By Eric Kades*

ABSTRACT

Trusts are one of the most flexible legal tools in lawyers' arsenals, deployed for socially desirable uses ranging from supporting orphans to structuring complex investments. Trusts, however, are also used for a host of socially undesirable purposes, including restraint of trade, cheating creditors, establishing family dynasties akin to feudalism, and avoiding taxes. This negative litany shows that flexibility has a dark side, and these undesirable trust uses have accelerated in the last few decades. Creative lawyers continuously find novel uses for moldable tools like the trust. This Article argues that long experience and recent developments teach us that dark eclipses light for private trusts: the costs of undesirable innovations exceed the benefits of desirable ones. Applying a novel normative theory of flexible legal tools, this Article calls for fundamental reform of private trust law. With a small exception for financial investments, the current fully flexible private trust should be replaced with a much less flexible device, the Restricted Donative Trust, designed to prevent abusive uses while permitting desirable innovations.

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* Eric Kades is the Thomas Jefferson Professor of Law at William & Mary Law School. He thanks Jonathan Blattmachr, Bridget Crawford, Phil Hackney, Anthony Infante, Ed McCaffery, Carlyn McCaffrey, Carla Spivak, Allison Tait, and Phyllis Taite.. A very special thanks to his colleague Alan Meese for generously educating him about the role trusts played in restraining trade in the late 19th century.

INTRODUCTION

This Article is not about monopolies and restraints of trade—it is not antitrust, but rather anti trusts. It may come as some surprise that in America's legal landscape, few things are less trustworthy than private trusts.[1] No doubt many private trusts do serve the virtuous purposes with which laymen associate them, such as providing for orphans or those with disabilities. Yet many trusts serve less admirable, even anti-social goals: avoiding millions or even billions of dollars in estate taxes; frustrating creditors of trust beneficiaries enjoying the high life; and establishing family dynasties reminiscent of feudalism.[2] Previous scholarship cited throughout this Article has lamented specific abusive trusts without considering the wider question: why are trusts so attractive to those seeking to skirt the law across a wide variety of domains? This Article provides a theoretical explanation for why trusts, an exalted element of equity, are the tool of choice for achieving a seemingly endless stream of inequitable ends. It then offers a policy prescription to prevent such undesirable practices while permitting socially useful trusts. As traced in Part I, deploying trusts to achieve objectionable ends is nothing new. Indeed, relatively soon after the appearance of the trust's precursor ("uses"), medieval scriveners redeployed the device to avoid "feudal incidents"—a tax dodge.[3] Over the

1. In this article, "trusts" generally refers to private (non-charitable) trusts.
2. *See infra* Part I.
3. *See infra* Part I.A.

ensuing centuries, creative lawyers have repurposed trusts for a wide variety of both worthwhile and worthless ends: financial security for orphans and others unable to support themselves of the positive side of the ledger; frustration of creditor;, dynastic family wealth; and tax avoidance on the negative side. Trusts played a central role in restraining trade during America's Gilded Age[4]—a socially pernicious practice that gave rise to the term "antitrust" as a synonym for competition laws.

The use of trusts to form oligopolies and stifle competition evoked a relatively swift reaction: the promulgation of the Sherman Antitrust Act of 1890,[5] the Clayton Act of 1914,[6] and a host of foundational cases fleshing out American antitrust law.[7] This aggressive response to an abusive use of trusts, however, seemingly is unique. At the same time that the government was reining in the steel, oil, and other oligopolistic trusts, state courts blessed the creation of "spendthrift" trusts enabling beneficiaries from privileged backgrounds to enjoy unbounded passive income streams while leaving their creditors high and dry.[8]

Deleterious uses of trusts have proliferated in recent decades. Originally, spendthrift trusts could be created only for others, e.g., parents could create them for their children but not for themselves.[9] Since the late 1990s, however, more and more states have permitted the wealthy to "self-settle" spendthrift trusts, placing their own assets beyond the reach of creditors.[10] The effective demise of the Rule Against Perpetuities has given rise to dynastic trusts capable of locking in family wealth for generations without end.[11] Continuing long tradition, estate-planning lawyers have created a veritable cornucopia of complex, highly specialized trusts for the *sole* purpose of avoiding the federal and state estate and gift tax: GRATs,[12] IDGTs,[13] ILITs,[14] QPRTs,[15] QTIPs[16], and SLATs,[17] just to name a few. This

4. RICHARD WHITE, THE REPUBLIC FOR WHICH IT STANDS: THE UNITED STATES DURING RECONSTRUCTION AND THE GILDED AGE 1865–96 (2017).

5. Sherman Act, 15 U.S.C. §§ 1–7 (2018).

6. Clayton Act, 15 U.S.C. §§ 12–27, 29 U.S.C. §§ 52–53 (2018).

7. *See generally* HANS B. THORELLI, THE FEDERAL ANTITRUST POLICY: ORIGINATION OF AN AMERICAN TRADITION (1955); RUDOLPH J.R. PERITZ, COMPETITION POLICY IN AMERICA 1888–1992: HISTORY, RHETORIC, LAW (1996).

8. *See infra* Part III.B, I.C.

9. *See generally* GEORGE GLEASON BOGERT ET AL., BOGERT'S THE LAW OF TRUSTS AND TRUSTEES §§ 222–223 ("Spendthrift trusts in the United States" and "Settlor creates spendthrift trust for self").

10. *See infra* Part I.D.1.

11. *See infra* Part III.B.3.

12. "Grantor-Retained Annuity Trusts."

13. "Intentionally Defective Grantor Trusts." A legal device that is defective by design cannot help but set off alarms.

alphabet soup of estate-planning trusts serves essentially no purpose other than sheltering vast wealth from taxation.

Although scholars have long lamented the social harms imposed by these trusts,[18] there has been little scholarship searching for the reason that trusts are the preferred means to achieve technically legal but socially undesirable ends. The foundation for explaining this phenomenon is the growing consensus that in substance, if not in form, *trusts are (unnatural) legal persons ("juridical entities")*, much like corporations or LLCs. Part II documents this consensus and, moreover, applies recent scholarship to highlight that the essential feature of trusts' power, for good and for bad, is the creation of a new, separate legal "box" to hold property separate and apart from beneficiaries and trustees.

In the theoretical core of this article, Part III situates trusts within a broader framework explaining why the law permits flesh-and-blood (natural) people to create unnatural legal entities. All other types of unnatural legal persons are tailored to specific uses and have either clear owners, clear purposes, or both. Business corporations are owned by shareholders with a shared purpose of making money. LLCs are much the same, though they are owned by "members" instead of shareholders. Partnerships (entities under the growing modern consensus) and LLPs (entities by definition) are owned by partners, again with a shared purpose of making money. Non-profit corporations, charitable foundations, and charitable trusts have no owners, and their purpose is to serve some charitable, scientific, religious, educational, or other similar group or cause.[19]

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14. "Irrevocable Life Insurance Trusts."

15. "Qualified Personal Residence Trusts."

16. "Qualified Terminal Interest Property Trusts."

17. "Spousal Lifetime Access Trusts."

18. John Chipman Gray vociferously (and unsuccessfully) thundered against spendthrifts trusts during their founding era. *See* JOHN C. GRAY, RESTRAINTS ON THE ALIENATION OF PROPERTY iii–xi (2d ed. 1895). See Mark Bennett and Adam Hofri-Winogradow, *The Use of Trusts to Subvert the Law: An Analysis and Critique*, 41 OXFORD J. LEGAL STUD. LEGAL STUD. 692, 697 (2021), for more recent scholarship highlighting socially undesirable use of trusts. *See also* Kent D. Schenkel, *Exposing the Hocus Pocus of Trusts*, 45 AKRON L. REV. 63, 119–27 (2012) (focusing on spendthrift trusts and avoiding spousal statutory elective share rights); Kent D. Schenkel, *Trust Law and the Title-Split: A Beneficial Perspective*, 78 UMKC L. REV. 181, 184 (2009) (same).

19. See the Model Nonprofit Corporation Act (MNCA) (2008), adopted by 37 states, for a prototypical non-profit corporation act. Charitable trusts are formed under the states' general law of trusts. "Foundation" is an imprecise term legally; "[a] private foundation may be either a not-for profit corporation or a trust." *Which Private Foundation is Right for You: Corporate or Trust Form?*, STERLING FOUND. MGMT., https://www.sterlingfoundations.com/_cache/files/c/e/ce52b2e1-4d8f-4e70-b5ae-9143c3117737/22798A0772D4F4F6B665E3F77DBEE681.-sfm-which-private-foundation-is-right-for-you—-corporate-or-trust-form.pdf (last visited Apr. 19, 2023).

In contrast, ownership of a trust can be divided across persons and time without limits, and on conditions of any sort.[20] Thus legal actors can use trusts to provide equal rights in a single jointly-owned family vacation home, and, at the other end of the spectrum, to asymmetrically divide up cash flows from a huge pool of mortgages among thousands or millions of investors. Similarly, trusts can serve any imaginable purpose, from providing support for an orphaned child to setting up a status-based family dynasty to running a mutual fund for the profit of its investors. [21]

Legal entities are very powerful tools. Like almost any sort of tool, they can be used for good or ill. Laws authorizing the creation of unnatural legal persons (legal entities), recognizing the danger of unfettered use of these juridical golems, carefully circumscribe ownership of such entities and the purposes that they serve. The core normative claim of this paper is that the trust is a uniquely flexible legal entity and that this flexibility enables creative lawyers to come up with an unending stream of novel trusts that subvert the optimal functioning of a variety of legal regimes.

Part III also shows in some detail how the flexibility of trusts facilitates private actions that frustrate the socially desirable operation of laws ranging from creditor-debtor relations to tax collection to equality of opportunity. Creditors face difficulties dealing with debtors who may have access to great wealth held in spendthrift trust.[22] The IRS is forced to play an unending game of whack-a-mole with inventive estate lawyers and their alphabet soup of novel trusts designed solely to avoid estate taxes.[23] These same clever lawyers can also use trusts to set up dynasty trusts to lock vast wealth up within a single bloodline forever.[24]

No other legal entity works as a substitute in any of these contexts. That, of course, is why lawyers resort to trusts in each of these contexts—and in so many others. Given their countervailing socially valuable uses, both familial and commercial, simply eliminating trusts altogether from the menagerie of unnatural persons is overkill, throwing the baby out with the bath water. Part IV,[25] applying a novel theory of flexible legal devices presented in Part II.A, argues that we should discard the current one-size-fits-all, inordinately flexible trust and replace it with a small set of more

20. Limitations on the time span of trusts disappeared with the effective abolition of the Rule Against Perpetuities. *See infra* Part I.D.2, III.B.3. See *infra* Part III.A.2, for the absence of restrictions on beneficiaries or conditions.

21. *See infra* Part III.A.2.

22. *See infra* Part III.B.

23. *See infra* Parts I.D.3, III.B.4.

24. *See infra* Parts I.D.2, III.B.3.

25. 2 FREDERICK POLLOCK & FREDERIC WILLIAM MAITLAND, THE HISTORY OF ENGLISH LAW BEFORE THE TIME OF EDWARD I 232 (2d ed. 1898).

narrowly purposed trusts that reserve maximal flexibility for socially desirable trusts and sharply constrains the terms of their socially undesirable counterparts. This reconfiguration preserves the value of flexible trusts but simultaneously blocks the singular ability of trusts to evade all sorts of laws of general application.

I. A SHORT SUMMARY OF THE LONG HISTORY OF ABUSIVE TRUSTS

This section provides a bird's-eye view of approximately 700 years of the use of trusts to achieve socially undesirable results. It introduces a cast of trust "characters" in order to give readers a sense of the number and the variety of trust types used to effectuate these objectionable ends, and to explain their defining features. We return to these illustrative trusts in Part III and take a closer look at the social costs that each imposes.

A. Pure at Birth, but Soon Corrupted

Precursors to common-law trusts ("uses") first appeared in 13th century England for purposes as pure as a newborn baby: entrusting friends to run estates for the benefit ("use") of wives and children of noble warriors off to fight foreign wars, or entrusting pious laymen to hold property for the benefit of friars and monks who had taken vows of poverty and hence could not own property in their own name. Within a couple of centuries, however, this novel device was being deployed primarily to avoid transfer taxes ("feudal incidents") on the death of property owners.[26] Henry VIII convinced Parliament to enact the Statute of Uses[27] to bar this tax dodge, but clever scriveners found creative tricks to defeat the law and continue to avoid taxes.[28]

B. Trusts as a Tool of Oligopolists

The next stop on our survey of the history of trusts is America's Gilded Age, the late 1800s, when creative lawyers harnessed the infinite flexibility of the trust to coordinate restraints of trade in a wide range of important markets.[29] There are few more (non-criminal) widely condemned anti-social

26. JOHN H. LANGBEIN, RENÉE LETTOW LERNER, BRUCE P. SMITH, HISTORY OF THE COMMON LAW 305–06 (2009).

27. An Acte Concnyng Uses & Wylles 1535–36, 27 Hen 8 c. 10 (Eng.).

28. LANGBEIN ET AL., *supra* note 26, at 306.

29. LAWRENCE FRIEDMAN, A HISTORY OF AMERICAN LAW 525 (2d ed. 1985); Edward G. Keasbey, *New Jersey and the Great Corporations*, 13 HARV. L. REV. 198, 201 (1899).

activities than monopolies and collusive agreements to limit supply (oligopolies). Economists of all stripes, along with layperson consumers, condemn the deadweight losses and higher prices that come with anticompetitive behavior.[30] Congress enacted fundamental competition laws—the anti*trust* laws—in reaction to large-scale anticompetitive behavior in a variety of industries, e.g., the "Oil Trust,"[31] the "Meatpacking Trust,"[32] and the "Sugar Trust."[33]

Trusts were the instrument of choice for scheming oligopolists in the late 1800s because, at that time, state corporate statutes did not permit corporations to merge or to buy stock in other corporations.[34] John D. Rockefeller and a small group of other oil barons came to control the lion's share of the U.S. oil market by the early 1880s. The Standard Oil Trust was created in 1882, and was apparently the first major oligopolistic trust formed in the United States.

> [The oil barons] proceeded to perfect an organization of the companies which had been brought under their control. For this purpose the various Standard and affiliated concerns were, on January 2, 1882, combined under what is known as the "Standard Oil Trust agreement." . . . In brief, it provided for a combination of the various interests controlled by the Standard group of capitalists and their immediate associates, but without a consolidated corporation. Instead of a single holding company, the entire system of properties was to be controlled by a board of trustees. In lieu of capital stock, trust certificates, so-called, were used in acquiring the interests taken over. . . .
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> Thus the small group of men who owned a majority of the trust certificates secured thereby a majority interest in and control of all the subsidiary concerns in the combination.[35]

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30. ANDREU MAS-COLELL, MICHAEL D. WHINSTON, & JERRY R. GREEN, MICROECONOMIC THEORY 384–87 (1995).

31. Standard Oil Co. of N.J. v. United States, 221 U.S. 30 (1911). See BRUCE BRINGHURST, ANTITRUST AND OIL MONOPOLY: THE STANDARD OIL CASES, 1890-1911 (1979), for a detailed history.

32. *See* Swift & Co. v. United States, 196 U.S. 375, 394–98 (1905); *see also* Gary D. Libecap, *The Rise of the Chicago Packers and the Origins of Meat Inspection and Antitrust*, 30 ECON. INQUIRY 242, 255–60 (1992).

33. United States v. E. C. Knight Co., 156 U.S. 1, 1 (1895).

34. FRIEDMAN, *supra* note 29, at 523–24.

35. 1 U.S. DEP'T OF COM. AND LAB., REPORT OF THE COMMISSIONER OF CORPORATIONS ON THE PETROLEUM INDUSTRY 66, 70–71 (1907). See *id*. at 361–70, for the entire trust agreement.

This creative use of the common-law trust "quickly became popular and was adopted by many businesses formed during the Industrial Revolution."[36] Circumventing regulation (here, early corporate law's prohibition of mergers and corporate ownership of another corporation's stock) is a theme observed time and again in the checkered history of the trust. As a "shape-shifting" legal device, the trust can mimic virtually any legal entity and any complex contract.

C. Spendthrift Trusts

During the same Gilded Age in which the federal government enacted the antitrust laws and aggressively litigated to break up oligopolistic trusts, state courts generally embraced the novel and controversial "spendthrift" trust.[37] By inserting a "spendthrift" clause into a trust, the settlor of a trust explicitly bars the beneficiary from selling her rights to receive distributions from the trust.[38] Thus a young "spendthrift" beneficiary who might wish to sell all of her future trust fund distributions in return for one lump sum, in order to fund, e.g., a gambling habit or a drug addiction, simply cannot do so. In order to effectuate the settlor's intent and prevent end-runs by beneficiaries, no creditor may satisfy a judgment against the beneficiary by levying on trust assets.[39] Thus, the trust interest of a beneficiary who convinces the casino to extend her credit, gambles, and loses is beyond the reach of the casino. Even more controversially, non-consensual creditors—tort victims injured by the beneficiary—cannot satisfy judgments from assets in a spendthrift trust.

Although almost entirely a matter of state law, the U.S. Supreme Court apparently was the impetus for establishing the validity of spendthrift trusts, endorsing them in dicta in 1875.[40] Massachusetts courts were first to clearly embrace spendthrift trusts in the 1880s.[41] Many other states soon followed

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36. Barak Orbach & Grace Campbell Rebling, *The Antitrust Curse of Bigness*, 85 S. CAL. L. REV. 605, 611–12 (2012). See People v. North River Sugar Refining Co., 3 N.Y.S. 401, 401–04 (1889), for judicial discussion of the sugar industry's trust.

37. *See supra* note 9, § 222.

38. *See generally* ERWIN N. GRISWOLD, SPENDTHRIFT TRUSTS 2–3 (2d ed. 1947).

39. Once the beneficiary receives a distribution from a spendthrift trust, the money is no longer trust property; as the personal property of the debtor beneficiary, any creditor can then attach the funds to satisfy a claim. Of course, the beneficiary can engage in all manner of subterfuge to hide the funds or spend them on consumption before creditors can attach them. Part III.B *infra* discusses these issues in some detail.

40. Nichols v. Eaton, 91 U.S. 716, 723–25, 730 (1875). Justice Miller's embrace of spendthrift trust may have been based on an erroneous reading of state law. Adam J. Hirsch, *Spendthrift Trusts and Public Policy: Economic and Cognitive Perspectives*, 73 WASH. UNIV. L. Q. 1, 6 n.17 (1995).

41. Broadway Bank v. Adams, 133 Mass. 170, 171–73 (1882).

suit[42] despite the vehement objections of the era's leading light in trusts and estates, John Chipman Gray.[43] Although we explore the surprisingly complex policy arguments for and against spendthrift trusts below in Part III.B.2, Gray summarizes some of the more common objections. He exalted "the duty of keeping one's promises and paying one's debts,"[44] and posited that spendthrift trusts facilitated the perpetuation of

> a privileged class whose power and wealth should not be endangered by the weakness or folly of particular members . . . . One of the worst results of spendthrift trusts . . . is the encouragement it gives to a plutocracy, and to the accumulation of a great fortune in a single hand, through the power it affords to rich men to assure the undisturbed possession of wealth to their children, however weak or wicked they may be.[45]

This in effect raises the specter of (a new) feudalism.[46] Perhaps the core moral objection to spendthrift trusts is that they raise the prospect of trust-fund babies enjoying lavish lifestyles while their contract creditors and tort victims go unpaid.

D. Recent Proliferation of Abusive Trusts

1. Asset Protection Trusts (i.e., Self-Settled Spendthrift Trusts)

Since their inception almost 150 years ago, there has been little, if any, retreat from the states' general blessing of spendthrift trusts. Indeed, since the late 1990s, a growing number of states have dramatically expanded the ambit of spendthrift trusts by permitting settlors to place *their own assets* into what is now commonly called an "asset protection trust."[47] Thus, continuing the example from the previous subsection, a person worried about future[48] gambling debts can protect herself by placing all of her assets

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42. LAWRENCE M. FRIEDMAN, DEAD HANDS, A SOCIAL HISTORY OF WILLS, TRUSTS, AND INHERITANCE LAW 117–18 (2009).

43. GRAY, *supra* note 18, at iii–xi.

44. *Id.* at iii.

45. *Id.* at vi.

46. In arguments with less contemporary resonance, Gray said that spendthrift trusts were an outgrowth of the nascent regulatory state and its rejection of pure laissez-faire capitalism, going so far as to tie such trusts to socialism. *Id*. at xi.

47. *See* BOGERT, *supra* note 9, § 223.

48. At least in theory, fraudulent transfer law prevents debtors from escaping accrued liabilities by transferring assets into an asset-protection trust. The cost to creditors of invoking rights under such statutes, however, may render them largely a nullity for all but the largest creditors.

in an asset protection trust. She will enjoy almost exactly the same protections that her daughter would enjoy from a spendthrift trust.

This is a major and controversial expansion of already controversial spendthrift trust protections. The fact that until the 1990s every state that permitted spendthrift trusts expressly refused to let settlors create such trusts for themselves strongly suggests that asset protection trusts are of greater concern.[49] Such an act of naked self-interest can hardly help but set off policy alarms. In addition, the origins of asset protection trusts are disquieting: they appeared first in obscure foreign jurisdictions with reputations for zealous protection of account holder secrecy and unconcealed hostility towards creditors, such as the Cook Islands, Belize, the Bahamas, the Cayman Islands, and others.[50] In a race to the bottom among states to attract bank deposits and trust funds, many states have followed suit and passed legislation authorizing the creation of asset protection trusts with robust protection from creditor claims.[51] "The driving force behind these legislative initiatives is clear enough. States are vying for trust business. The state legislature of Delaware has been quite candid (even brazen) about its intentions—which are 'to maintain Delaware's role as the most favored domestic jurisdiction for the establishment of trusts.'"[52]

Sterk captures the instinctual distaste for asset protection trusts by those who might not recoil from spendthrift trusts. "[A]lthough courts and legislatures have had some sympathy for property owners seeking to protect their imprudent or profligate children, the notion that property owners ought to be able to protect themselves against their own profligacy, at the expense of their creditors, has been much harder to swallow."[53] Profligacy is the least of the sins enabled by asset protection trusts. It takes little imagination to think up schemes using asset protection trusts in furtherance

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49. See RESTATEMENT (SECOND) OF TRUSTS § 156(1) (1959), for this traditional rule. "Where a person creates for his own benefit a trust with a provision restraining the voluntary or involuntary transfer of his interest, his transferee or creditors can reach his interest." *Id.* See RESTATEMENT (THIRD) OF TRUSTS § 58(2) (2003), for the current rule. "A restraint on the voluntary and involuntary alienation of a beneficial interest retained by the settlor of a trust is invalid." *Id.*

50. *See* Stewart E. Sterk, *Asset Protection Trusts: Trust Law's Race to the Bottom*, 85 CORNELL L. REV. 1035, 1048 (1999) ("Starting in the mid-1980s . . . several offshore jurisdictions identified a new source of trust business: clients seeking to avoid not taxing authorities, but creditors."); *see also* James T. Lorenzetti, *The Offshore Trust: A Contemporary Asset Protection Scheme*, 102 COM. L.J. 138 (1997); Elena Marty-Nelson, *Offshore Asset Protection Trusts: Having Your Cake and Eating It Too*, 47 RUTGERS L. REV. 11, 57 (1994).

51. Marty-Nelson, *supra* note 50, at 57.

52. Adam J. Hirsch, *Fear Not the Asset Protection Trust*, 27 CARDOZO L. REV. 2685, 2687 (2006) (internal citation omitted).

53. Sterk, *supra* note 50, at 1044.

of inequitable or even illegal ends, and, in fact, such hustles have made it into the case law with some regularity:

- spouses avoiding equitably dividing property in a divorce;[54]

- professional defendants planning ahead to avoid compensating future malpractice victims;[55]

- taxpayers planning to defraud the IRS;[56] and

- money laundering.[57]A tool that facilitates such a panoply of antisocial scheming invites critical scrutiny.

2. Dynastic Trusts

Originally, lawyers crafted asset protection trusts to wall off the wealth of *a single individual for life*. With the demise of the Rule Against Perpetuities (RAP),[58] such trusts can be combined with another socially dubious innovation of recent origin, the dynastic trust, to protect *a family fortune forever*. In this brave new RAP-free world, very wealthy testators can establish trusts that last forever. Distributions from these "dynasty trusts" can take many forms, from equal benefits to successive generations of the settlors' progeny[59] to picking and funding the most promising descendants in an endless quest to maximize the status of the settlors' bloodline.[60] Dynastic trusts invariably include spendthrift provisions to prevent wastrel descendants from bankrupting the settlor's medievalist dream of founding and funding an unending dynasty of aristocrats. In a nation founded in large part on a rejection of the remnants of English feudalism, it is bizarre and perverse that in contemporary America it is now possible to create new noble bloodlines lasting for generations without end.

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54. Riechers v. Riechers, 178 Misc.2d 170, 172 (N.Y. Sup. Ct. 1998).

55. *Id*; *see id.* at 173; *In re* Rowen, 298 B.R. 641, 644 (Bankr. D. Alaska 2003).

56. *See Rowen*, 298 B.R. at 651; *In re* Manshul Constr. Corp., 2000 WL 1228866, at *1 (S.D.N.Y. 2000).

57. United States. v. McBirney, 261 F.App'x. 741, 745–46 (5th Cir. 2008) (per curiam).

58. See Eric Kades, *Of Piketty and Perpetuities: Dynastic Wealth in the Twenty-First Century (and Beyond)*, 60 B.C. L. REV. 145, 152 (2019), for a summary of the effective disappearance of the Rule Against Perpetuities.

59. *Id.*

60. Eric Kades, *A New Feudalism: Selfish Genes, Great Wealth and the Rise of the Dynastic Family Trust* 2 (Feb. 4, 2021) (unpublished manuscript) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3779460).

Part III.B makes out the rather easy case that dynastic trusts are a decidedly undesirable development enabled by the common-law trust.

3. The Modern Alphabet Soup of Estate-Planning Trusts

For those establishing dynasty trusts, and for many establishing simpler estate plans, minimizing taxation is important. The income tax on trusts plays some role,[61] but for the very wealthy (those for whom founding a high-status dynasty is feasible) minimizing federal transfer taxes (the estate, gift, and generation-skipping taxes) is paramount, as without complex planning these taxes will take 40% of the *principal* of the trust *each generation* (roughly every 25 years).[62] With billions of dollars at stake, it can be no surprise that lawyers for would-be dynasts have come up with numerous stratagems to minimize estate taxes.[63]

There is a long list of specialized trusts used to reduce estate taxes, referred to by a dizzying "alphabet soup" of acronyms.[64] This subsection briefly introduces one commonly used ingredient in this soup, grantor retained annuity trusts (GRATs), to provide a sense of how trusts facilitate avoidance of estate taxes. As this device involves complex provisions of the tax code, our description is somewhat oversimplified but covers its essential features.

GRATs are the latest incarnation of an old trick commonly labeled "asset freezes" or "estate freezes."[65] The idea is to place property expected to appreciate significantly in the future into a trust with two beneficiaries: (i) the owner and settlor of the trust receives a fixed stream of payments for a fixed number of years (i.e., an annuity), and after all of these payments have been made, then (ii) others, usually descendants of the settlor, receive the property outright.[66] In order to comply with the tax code and both minimize the amount of the (potentially taxable) gift to descendants and avoid entirely any tax on the expected appreciation of the property, the net present value of the annuity payments to the settlor must equal most or all of the value of the property being placed in trust.[67] If the taxpayer can convince the IRS of this fact, then the value of the future interest she is

61. I.R.C. §§ 641–92 (Internal Revenue Code provisions for tax on trust income).

62. I.R.C. § 2001.

63. This article generally uses "estate tax" as a shorthand for estate, gift, and generation-skipping taxes.

64. *See supra* notes 12–17.

65. PAUL R. MCDANIEL ET AL., FEDERAL WEALTH TRANSFER TAXATION 752–59 (7th ed. 2015).

66. *Id.*

67. *Id.*

gifting to her descendants is zero or close to zero. Gifts of zero value cannot incur any gift tax, and gifts worth minimal amounts can incur only minimal gift taxes.

What is financially dissonant here is that basic economics tells us that assets expected to appreciate tomorrow are worth more today, as expected future appreciation is "capitalized" into the current price.[68] If there is a high probability that stock in a start-up will be worth $10 million in a year, standard valuation techniques should make it impossible to assign a value of only $1 million to the shares. In order for GRATs to achieve their twin goals of minimizing gift taxes and avoiding altogether any transfer tax on the appreciation of the stock, however, taxpayers must convince the IRS that the current value of the assets is only $1 million. This is impossible if the shares are publicly traded, as their current value will reflect expected appreciation, and so GRATs invariably involve stock in privately held firms. Thus, the economic essence of a GRAT, the reason that they help settlors avoid taxes, is rooted in asymmetric information: the taxpayer has knowledge of expected appreciation that the IRS lacks and cannot obtain at reasonable cost. The taxpayer thus leverages her superior information to trick the IRS by attaching an artificially low value to the assets placed in a GRAT ($1 million in the example above).

Such tax avoidance by exploitation of the taxing authority's imperfect information is socially undesirable. Taxpayers divert resources from more desirable uses to concoct such tax stratagems, and the taxing authority wastes some resources trying to ferret out the most extreme cases of asset undervaluation. The only reason GRATs exist is that they assist taxpayers in fooling the tax authorities. As discussed below,[69] trusts are essential to facilitating this tax ruse. Congress could try to craft new provisions to prevent such abuse, but the problem is deeper and better addressed at its root. The common-law trust is too flexible. We can minimize its potential for misuse, in GRATs or in the other examples considered in preceding subsections, by attacking the problem at its root and reining in the excessive malleability of private trusts.

68. See Boris I. Bittker, *Tax Shelters and Tax Capitalization, or Does the Early Bird Get a Free Lunch?*, 28 NAT. TAX. J. 416 (1975), for an amusing but surprisingly deep and subtle discussion of the "capitalization" of possible future legal changes into asset prices,.

69. *See infra* Part III.B.4.

II. TRUSTS IN THE CONTEXT OF A THEORY OF THE FLEXIBILITY OF LEGAL ENTITIES

A. Sketching a Theory of Optimal Flexibility in Legal Tools

The kernel of this Article is that, overall, trusts are too flexible for the public good. Making this case requires some theory of flexibility. I could find nothing extant in the legal or social science literatures. Thus, this subsection offers the outlines of a pioneering theory of the optimal amount of flexibility to permit in private legal devices, ranging from self-help to property to legal entities like corporations, LLCs, and (of direct relevance to this Article) trusts.[70]

The motivating insight for this theory is that a legal device designed for purpose X will also prove suitable for other purposes (Y, Z, . . .) if it is flexible—indeed, this can be taken as the definition of flexibility. Using this Article's subject to illustrate, private trusts may have been invented as a device for English noblemen to arrange for the management of their estates while they went off on the Crusades but have been used for a wide variety of other purposes in the ensuing centuries.[71] Part I introduced four undesirable purposes for which creative scriveners have deployed trusts. Conversely, people have also found novel positive uses of trusts, especially in the realm of commerce and finance, including collateralized debt obligations (CDOs) and mutual funds.[72]

The flexibility of legal tools rarely is one dimensional. The most flexible of legal tools, contracts, can vary in a seemingly unbounded number of dimensions, e.g., number of parties, length of relationship, number and type of contingencies, and remedies, just to list some prominent examples.[73]

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70. I plan to provide a detailed explication of this theory of optimal flexibility of legal tools in a separate article.

71. Lindsay Dean Breach, *The Development of the Use and the Origins of the Modern Trust: Maitland's Thesis, the Crusades, and Beyond* (2018) (unpublished Ph.D. dissertation, University of Canterbury) (available at https://ir.canterbury.ac.nz/bitstream/handle/10092/15387/Breach,%20Lindsay_Final%20PhD%20Thesis.pdf?sequence=1) (thorough assessment of role Crusader's estate planning played in development of trusts).

72. John H. Langbein, *The Secret Life of the Trust: The Trust as an Instrument of Commerce*, 107 YALE L. J. 165, 183–84 (1997). A brief introduction to mutual funds and CDOs appears *infra* text accompanying notes 180–92.

73. Thomas Merrill and Henry E. Smith, *Optimal Standardization in the Law of Property: The* Numerus Clausus *Principle*, 110 Yale L.J. 1, 3 (2000). As Merrill and Smith note:

> The law of contract recognizes no inherent limitations on the nature or the duration of the interests that can be the subject of a legally binding contract . . . .

Each dimension may cover a continuum or involve only a finite number of options. To give an example of a continuum in trust law, settlors can select beneficiaries' power to remove trustees from anywhere along a continuum, from power to remove at will on one end, to no power to remove at the other, and many options in between, e.g., option to change trustee every 2, 5, 10, . . . years or the right to remove trustees for a long or short set of misdeeds or carelessness.[74] A simple example of a small set of discrete options from trust law is the binary choice of whether to appoint beneficiaries or third parties as trustees.

The easiest case for addressing excessive flexibility of a legal tool is when private actors use a given dimension of flexibility exclusively to achieve socially undesirable ends. If lawmakers can identify such invidious types of flexibility, they can limit or completely eliminate them. Two examples illustrate such judgments. First, the consideration requirement in Anglo-American contract law, which refuses to enforce promises to make future gifts, reflects a policy judgment that, net-net, any gains from validating such pledges are swamped by countervailing costs.[75] Second, the law of marriage has expanded over the last few decades to permit same-sex unions[76] but remains steadfast in refusing to accede to anyone's desires to be part of bigamous or larger polyamorous marriage.[77] Marriage is quite flexible in many regards (separate or combined finances; living together or apart; tolerating extra-marital sexual relationships) but lawmakers have not wavered in their judgment that flexibility in the number of parties to a marriage is socially pernicious.

Unfortunately, Part III.B will show that there is little overlap in the dimensions of flexibility used to achieve the various undesirable ends of the trusts introduced in Part I. An alternative and initially attractive means to address excess flexibility is to reduce it. For continuous dimensions and those with a relatively large number of discrete levels of flexibility, this

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> [T]here is a potentially infinite range of promises that the law will honor. The parties to a contract are free to be as whimsical or fanciful as they like in describing the promise to be performed, the consideration to be given in return for the promise, and the duration of the agreement.

74. *See generally* BOGERT, *supra* note 9, § 520 ("Provisions in trust instrument regarding removal.").

75. *See* JOSEPH M. PERILLO & HELLEN H. BENDER, *Formation of Contracts*, *in* 2 CORBIN ON CONTRACTS 1–3, 197, 342 (rev. ed. 1995).

76. See DEBBIE CENZIPER & JIM OBERGEFELL, LOVE WINS: THE LOVERS AND LAWYERS WHO FOUGHT THE LANDMARK CASE FOR MARRIAGE EQUALITY (2016), for a detailed history of the acceptance of same-sex marriage.

77. *See* Elizabeth Emens, *Monogamy's Law: Compulsory Monogamy and Polyamorous Existence*, 29 N.Y.U. REV. L. & SOC. CHANGE 277, 287–91(2004) (Section II, "Compulsory Monogamy").

means limiting the range of permissive values, e.g., limiting trust assets to $500 million or less, $400 million or less, and so on. The ability to modulate flexibility along such fine-grained continua has surface appeal. Surely, given the infinity of choices, mustn't there be some optimal level of flexibility? No, generally not: this line of thinking is almost always misguided. To determine the optimal level of a continuous dimension, like the maximal permitted value of trust assets, we would need to have a very good idea about the relative benefits from desirable trusts and costs from undesirable trusts across a wide range of asset values. With such data, we could identify the amount of flexibility that maximizes social welfare. No such data exists, however, and it is hard to imagine it ever becoming available.

Thus, dialing flexibility to some optimal level is infeasible, and for trusts we observed above (and show below in Part III.B) there is no clear subset of nefarious types of flexibility to target. The failure of these two "fine-tuning" approaches means that we must use a "broad-brush" approach to corral the excessive flexibility of trusts. As summarized in Part I and detailed in Part III, trusts again and again have proven to be a potent means of legal innovations for achieving anti-social ends. Undeniably, other inventive trust uses have been socially desirable, e.g., CDOs and mutual funds.[78] A key premise of this Article, however, is that negative trust innovations have outweighed positive ones.

This premise plays a central role in the theory of flexibility applied to trusts in this Article. As actors gain experience with a flexible legal tool like the trust, they learn and adapt. A well-functioning legal system encourages socially valuable uses while discouraging or banning undesirable uses. The theory of flexibility articulated here does not focus on the history of this process but rather is forward looking. There are always novel applications of flexible tools. From the policy perspective espoused by this article, the key variable is the *expected net benefits* from this continuing stream of unforeseen uses. This, of course, is not calculable in any sort of precise way and may elude even rough estimation. In at least some cases, however, long experience may suggest that desirable unforeseen uses outweigh undesirable ones; this may be the case for business corporations. Conversely, this Article postulates that innovative trust uses have a net negative value.

In making this determination for a flexible legal tool, the core policy determinants are two symmetric sets of costs. If the law permits flexibility, we enjoy gains from desirable innovations, but will bear the cost of dealing

78. *See supra* note 72 and accompanying text.

with creative but undesirable novel uses of the tool. These costs include both the social cost imposed during the lifetime of the objectionable uses and the costs of eventually eliminating it via legislation, executive action, or judicial precedents. Conversely, if we opt to bar the use of a legal tool, we suffer a "shadow" loss of desirable uses until proponents can convince some legal actor (again, legislature, executive, or judicial) to formulate some legal tweak that enables the innovation.

As noted earlier, the costs identified in the previous paragraph are impossible to calculate with any precision. We can, however, make some plausible assumptions. First, both sets involve the cost of legal change (either to eliminate unwanted innovations or to enable desirable ones) and it seems natural to assume that these costs are, on average, equal. It is difficult to come up with a reason that the legal costs of suppressing objectionable innovation differ from the legal costs of enabling such changes.

Under this assumption that legal change costs are a wash, the issue reduces to comparing the value of the "temporary" beneficial versus detrimental novel uses of the flexible legal tool, where temporary denotes the time it takes to instantiate a law that either bans an undesirable use for an overly flexible tool or permits a desirable use for an inflexible tool. Although these quantities again do not admit of precise calculation, sizing up observed novel uses of a flexible legal tool over an extended period of time can provide some evidence that the value of beneficial innovations exceeds that of the negative ones. To repeat once more: a core assertion of this Article is that for donative trusts the costs exceed the benefits.

The broad-brush solution for such "negative value" excessively flexible legal tools is to replace the troublesome tool with (i) a narrower version of the flexible tool limited to existing desirable uses, along with (ii) a set of much less flexible legal tools to permit the valuable subset of potentially abusive uses. The goals of this division are to (i) capture the value of flexibility for those purposes that yield social benefits, and (ii) pare down generally undesirable uses to any narrower beneficial purposes. Part IV below sketches how lawmakers should apply this approach, eliminate the overly general and flexible law of private trusts, and replace it with a similarly flexible tool for beneficial purposes and much more constricted tools for each generally detrimental purpose. We call this the "restrictive regime."

In the happier milieu of flexible legal tools used predominantly for socially productive purposes, we have a very different (and simpler) "permissive regime." It is socially optimal to maintain the existence of flexible tools in these circumstances because of the relatively high positive value of innovative uses that they enable. When users do invent uses of these tools that are pernicious, lawmakers operating a permissive regime do need to promulgate rules barring the use of the flexible tool for such undesirable ends.

Some examples will clarify the thinking behind the restrictive and permissive regimes to deal with flexible legal tools. First, consider the storied history of self-help—taking the law into one's own hands, frequently by use of bodily force or seizure of property. In medieval times, with no organized policing and a largely rural, sparse population, the permissive regime reigned for self-help.[79] Most legal enforcement at least started with it, and often ended with it as well.[80] As the only tool in town to curb anti-social behavior, self-help was generally permitted—society exploited its utility and permitted most uses despite the potential for abuse, given its extraordinary value in maintaining a semblance of law and order. Today, well-functioning police, courts, and related institutions have almost entirely replaced self-help.[81] The legal system has adopted a very simple categorical rule: with very few exceptions,[82] self-help is permitted only in self-defense, defense of others, and in narrow circumstances to defend property.[83] Thus, permissiveness is out, and the restrictive regime governs self-help today. Only this very limited menu of uses seems desirable given effective policing and well-functioning courts. In this day and age, innovative uses of self-help are likely to be undesirable.

Property law's *Numerus Clausus* principle offers a second example of a restrictive regime. Under Numerus Clausus, the law permits only a small number of types of property rights and private parties may not invent any on their own.[84] There are at least two policy justifications for this doctrine: Merrill and Smith argue that limiting property interests to a small list reduces transactions costs;[85] Hansmann and Kraakman argue that Numerus

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79. POLLOCK & MAITLAND, *supra* note 25, at 578–80.

80. *Id.*

81. *See, e.g.*, Berg v. Wiley, 264 N.W.2d 145, 149, 151 (Minn. 1978) (presenting a typical modern case eliminating traditional right of landlords to use self-help to oust tenant violating lease).

82. Under the U.C.C. and in many states, creditors with security interests in personal property may still use self-help to repossess pledged property of delinquent debtors as long as the creditor or her agents avoid breaching the peace and otherwise proceed in a reasonable manner. *See, e.g.*, Droge v. AAAA Two Start Towing, Inc., 468 P.3d 862, 867, 871 (Nev. Ct. App. 2020) (retaining right of car loan creditor to repossess car of borrower in default).

83. *See, e.g.*, RESTATEMENT (SECOND) OF TORTS: CHARACTER AND EXTENT OF FORCE PERMISSIBLE § 70 (1965).

84. *See, e.g.*, CHARLES DONAHUE, JR. ET AL., CASES AND MATERIALS ON PROPERTY: AN INTRODUCTION TO THE CONCEPT AND THE INSTITUTION 457 (3d ed. 1993) (" [T]he common law regarded the system of estates as closed.").

85. Thomas W. Merrill & Henry E. Smith, *Optimal Standardization in the Law of Property: The Numerus Clausus Principle*, 110 YALE L.J. 1, 8 (2000).

Clausus revolves around efficiently giving notice to others of rights that apply when property interests are sold (rights that "run with the asset").[86] It is of course possible that some novel and very useful property interests crafted by private parties might create value. The legal system, however, seems to have concluded that negative innovations are more likely than positive ones, and so the categorical, limited-menu solution is preferable. Put differently, the law has concluded that the costs of excessive flexibility in the creation of novel property rights exceed any benefits.

In contrast to property law's restrictive Numerus Clausus doctrine, contracts operate under the permissive regime.[87] With some narrow exceptions,[88] parties can contract in any domain with whatever terms suit them. One prominent exception: in order to maintain a bright line between enforceable deals and promises to make future gifts, contracts must be supported by consideration.[89] But such exceptions are rare. Most innovative contracts are valuable and hence the law does not limit parties to anything remotely like Numerus Clausus in property but does engage in selected limitations on contracts' otherwise unlimited flexibility when private actors deploy contractual flexibility in socially costly ways.[90]

To take a final example closer to trusts, the permissive regime applies to business entities. People may form business corporations and similar entities (e.g., LLCs; limited partnerships) for virtually any purpose. There is no limited menu from which incorporators must choose. Articles of incorporation need not even include a purpose in many states,[91] and articles containing a purpose provision most typically have some version of the capacious "to make money for shareholders."[92]

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86. Henry Hansmann & Reinier Kraakman, *Property, Contract, and Verification: The* Numerus Clausus *Problem and the Divisibility of Rights*, 31 J. LEGAL STUD. S373, S379 (2002).

87. *See supra* note 73.

88. *See* TIMOTHY MURRAY, *Contracts Contrary to Public Policy, in* 15 CORBIN ON CONTRACTS 26, 340–42 (rev. ed. 2020).

89. *See* PERILLO & BENDER, *supra* note 75, at 2 (consideration requirement).

90. *See supra* note 73.

91. *See, e.g.*, ABA, MODEL BUS. CORPS. ACT § 3.01(a) (2016) ("Every corporation incorporated under this Act has the purpose of engaging in any lawful business unless a more limited purpose is set forth in the articles of incorporation.").

> It shall be sufficient to state, either alone or with other businesses or purposes, that the purpose of the corporation is to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of Delaware, and by such statement all lawful acts and activities shall be within the purposes of the corporation, except for express limitations, if any.

DEL CODE ANN., tit. 8, § 102(a)(3) (2020).

92. See Jill E. Fisch & Steven Davidoff Solomon, *Should Corporations Have a Purpose?*, 99 TEX. L. REV. 1309, 1313–18 (2021), for a cogent overview of the history of corporate purpose doctrine.

B. What is a Legal Entity?

In an influential contribution, Hansmann and Kraakman identified the core function of corporate and other entity laws as partitioning assets into distinct groups and establishing relatively complicated, multi-party rights over each set of assets.[93] Limited liability generally protects shareholders from corporate creditors.[94] Operating in the other direction, corporate law gives unsecured corporate creditors a "floating lien" on corporate assets, with strict priority over creditors of all shareholders.[95] Yet corporate law modulates the extent to which parties can manipulate these partitions. Veil-piercing, for example, is a well-known exception to limited liability, defeating shareholder acts that unfairly or fraudulently partition assets between the corporation and their personal holdings.[96]

Hansmann and Kraakman's asset-partitioning theory of the corporation is a relatively recent and cogent answer to the historically vexing endeavor of providing a theory explaining the existence of "legal entities"—nonhuman creations of the law given the rights to hold property and to be a party to legal actions.[97] Academics have devoted copious ink to this question.

Nearly 100 years ago, one scholar lamented the proliferation of theories, wryly noting that "the number of jurists who attempt to grapple with this problem is so large that legal authors may be divided into two groups: those who have written on the nature of legal persons, and those who have not yet done so."[98] Like others before and since, Wolff bravely attempted to summarize and synthesize the many theories offered to explain the true nature of legal persons. Are they legal fictions? Do they exist separate and apart from the humans who own and control them? Hansmann and Kraakman implicitly deem such philosophical inquiries moot and instead focus on the practicalities of permitting nonhuman entities to have

93. Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE. L.J. 387, 390 (2000).

94. *See, e.g.*, ABA, *supra* note 91, § 6.22.

95. Hansmann & Kraakman, *supra* note 93, at 440.

96. *See* JESSE H. CHOPER, JOHN C. COFFEE, & RONALD J. GILSON, CASES AND MATERIALS ON CORPORATIONS 246–77 (8th ed. 2013).

97. Synonyms for the phrase "legal entity" include "legal person," "juridical person," and "artificial person." It is defined as an "[e]ntity, as a firm, that is not a single natural person, as a human being, authorized by law with duties and rights, recognized as a legal authority having a distinct identity, a legal personality." *Juridical Person*, THE L. DICTIONARY, https://thelawdictionary.org/juridical-person/ (last visited Feb. 4, 2023). In practical doctrinal terms, a legal person is a non-human entity authorized by law to hold property and to be a party to lawsuits.

98. Martin Wolff, *On the Nature of Legal Persons*, 54 L.Q. REV. 494, 494 (1938).

the essential badges of legal existence, in particular the power to hold property in their own name.[99]

As might be inferred from their ubiquitous use, companies (a term used in this article to reference corporations and other business entities, e.g., limited-liability companies, limited partnerships, limited-liability partnerships, and others) are very useful, powerful legal tools. Walling off pools of assets and granting complex claims on each separate partition to numerous humans and legal entities turns out to be incredibly useful in organizing a modern, sophisticated economy driven by the deployment of capital. Two key dimensions arise in this asset partitioning at the heart of legal entity law: (i) ownership, and (ii) control. In partnerships, especially small partnerships, the partners both own and control partnership assets; so too in non-public corporations with few shareholders.[100] At the other extreme, shareholders of a large public corporation own the firm's assets but control them only in a weak and indirect way, via board of director elections that are usually uncontested.[101] Trusts can mimic either of these models. Settlors can be both trustees (control) and beneficiaries (owners); alternatively, settlors can appoint independent trustee(s) and make either themselves or others the beneficial owners.

C. Trusts are Legal Entities

The previous sentence casts trusts as legal entities. This is a critical assertion for this Article, as its fundamental theoretical argument is that the common-law trust enables the wide variety of undesirable behavior limned in Part II because it is an excessively flexible legal entity. Until quite recently, however, legal doctrine generally did not view trusts as legal persons.[102] Property "in" a trust is owned in split fashion (legal or

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99. "We have sought to offer here a definition of *juridical persons* that is simpler, clearer, and more functional than those that have characterized the traditional literature." Hansmann & Kraakman, *supra* note 93, at 439 (emphasis added).

100. Anticipating the evolution towards treating trusts as legal entities discussed in the next subsection, partnerships were long viewed as mere agglomerations of partners without a separate legal existence. The last few decades have seen a sea change and now most jurisdictions view partnerships as distinct juridical persons. NAT'L CONF. OF COMM'RS ON UNIF. STATE LS., REVISED UNIFORM PARTNERSHIP ACT § 201 (2022) ("A partnership is an entity"). See Daniel S. Kleinberger, *The Closely-Held Business Through the Entity-Aggregate Prism*, 40 WAKE FOREST L. REV. 827, 829 (2005), for an overview of this evolution.

101. *See* CHOPER ET AL., *supra* note 96, at 417–18 (stating that contested elections for slates of directors are uncommon for public corporations in the United States).

102. BOGERT, *supra* note 9, § 712 ("A trust is not a legal person, nor is the trust property."); *see also id.* § 731; Morrison v. Lennett, 616 N.E.2d 92, 94 (Mass. 1993) (noting that aside from statutory exceptions for business trusts, "a trust is not a legal entity which can be sued directly").

managerial title to the trustee; beneficial or equitable title to the beneficiaries), and as a matter of form there is nothing left for any newly instantiated legal entity to hold. Unhappy beneficiaries or third parties can sue trustees, but there simply was no "trust entity" to hold property, sue, or be sued.

This has all changed rapidly in the last few decades. The current Restatement of Trusts summarizes this trend:

> Technically, the trust is still not generally recognized as a legal "entity," but it is generally for federal tax purposes, and in practice trustees act on behalf of their trusts and are sued as trust representatives. Indeed, in this Chapter and elsewhere in this country, the trust is *treated* as an entity to such an extent that it is no longer inappropriate to refer to claims against or liabilities of a "trust" . . . or to refer to and treat trusts, in law and in practice, as if they were entities in numerous other contexts.[103]

Although case law remains mixed, the modern trend is to treat trusts as legal entities capable of holding property and being parties to lawsuits.[104]

Substance and practicalities align with this recent doctrinal shift classifying trusts as legal entities. As Hansmann and Mattei put it:

> [T]rust law provides for the creation of an entity - the trust - that is separate from the three principal parties [settlor, trustee, beneficiaries]. Under trust law, the Managed Assets are the property . . . of the trust, not of the three parties associated with it, and particularly not of the Manager [trustee], despite her legal title to the assets. And the trust, in turn, is the property of the Recipient [beneficiary] . . . and not of the Manager or the Transferor [settlor]. . . . The trust as entity bears an obvious resemblance to the corporation. It has effective legal personality, and the assets it holds are subject to a pattern of creditors' rights

103. RESTATEMENT (THIRD) OF TRUSTS. pt. 6, ch. 21, intro. note (2012) (AM. L. INST., amended 2022); *see also* RESTATEMENT (THIRD) OF TRUSTS. § 2 cmt. a (2003) (AM. L. INST., amended 2022) ("Increasingly, modern common-law and statutory concepts and terminology tacitly recognize the trust as a legal "entity," consisting of the trust estate and the associated fiduciary relation between the trustee and the beneficiaries.").

104. *See, e.g.*, Tatarian v. Com. Union Ins. Co., 672 N.E.2d 997, 999–1000 (Mass. App. Ct. 1996); Lewiston v. Kohut (*In re* Lewiston), 539 B.R. 154, 161 (Bankr. E.D. Mich. 2015); Lake Oswego Pres. Soc'y v. City of Lake Oswego, 379 P.3d 462, 465, 469 (Or. 2016). See Raymond Loubier Irrevocable Tr. v. Loubier, 858 F.3d 719, 722 (2d Cir. 2017), for a case maintaining the traditional view that trusts are not entities.

> essentially the same as those that characterize the corporation . . . .[105]

On this basis, Hansmann and Kraakman conclude in later scholarship that "[w]hile it is sometimes said that the common-law trust lacks legal personality, in our view it is, on the contrary, quite clearly a legal entity, and trust law is consequently a form of organizational law."[106]Sitkoff similarly finds that "classifying trust law as organizational law, and subjecting it to agency cost analysis, is the logical next step in the nascent economic analysis of the donative private trust."[107]

D. The Unparalleled Flexibility of the Trust Entity

There seems to be universal agreement that the trust entity is an extraordinarily flexible legal tool. Sitkoff adverts to trust law's "highly enabling, elastic, flexible, and default nature with respect to in personam relations."[108] Sterk notes that "[t]he trust's success has, in large measure, been attributable to its flexibility . . . no inherent limitations exist on the purposes for which a trust may be created."[109] Like most concepts, flexibility is relative. Hansmann and Mattei make the key comparison of trusts to the obvious alternative: companies.[110] "[I]t is necessary to ask next what the law of trusts adds to corporation law. The most general answer to this question is: flexibility. Trusts are free of many of the restrictions that are placed upon corporations by even the more liberal business corporation statutes."[111]

The singular flexibility of trusts, however, goes beyond freeing entity creators of the shackles of corporate or other business entity regimes (e.g., issuance of stock or other indicia of ownership; ultimate control vested in voting ownership interests). There is a relatively long list of trust features that provide flexibility simply unavailable in any other legal entity, corporate or otherwise, for-profit or non-profit. My research did not

105. Henry Hansmann & Ugo Mattei, *The Functions of Trust Law: A Comparative Legal and Economic Analysis*, 73 N.Y.U. L. REV. 434, 470, 472 (1998). Hansmann and Mattei purposefully use generic terms for the parties to a trust: "Transferor" for settlor, "Manager" for trustee, and "Recipient" for beneficiary.

106. Hansmann & Kraakman, *supra* note 93, at 416.

107. Robert Sitkoff, *An Agency Costs Theory of Trust Law*, 89 CORNELL L. REV. 621, 626 (2004).

108. *Id.* at 629.

109. Sterk, *supra* note 50, at 1041.

110. This article uses "company" to refer to any business entity, e.g., a corporation, an LLC, a limited partnership.

111. Hansmann & Mattei, *supra* note 105, at 472.

uncover any comprehensive enumeration of the factors that make the trust such a flexible entity, and so the remainder of this subsection provides such a list. Beginning with the core of legal entities, asset partitioning, trusts can provide ownership (beneficial) interests unavailable in any other entity. Anyone receiving non-contractual benefits from a corporation, LLC, or other business entity must possess some form of ownership, such as shares or membership rights. Trusts can mimic this feature, as is done with mutual funds and CDOs,[112] but "classic" donative trusts create beneficiaries who lack any such legal indicia of ownership. This lack of an attachable asset enhances protection from creditors even without the use of a spendthrift provision. Creditors of a shareholder can seize shares in satisfaction of a judgment, but creditors of trust beneficiaries frequently can do nothing of the sort. If, for example, all payments from the trust are discretionary, the beneficiaries of non-spendthrift trusts have no attachable property interest as they have no right to any distributions.[113] Corporate shareholders might try to emulate trusts by granting themselves security interests in the company's assets, but this security interest is just as attachable by personal creditors as are shares. Again, this absolute absence of any attachable interest is an inherent feature of trusts, even without the use of a spendthrift provision. Such terms, of course, provide even more ironclad partitioning off of assets from creditors' claims unavailable outside of the law of trusts.

The trust is also a powerful precommitment tool. The oligopolists of the late 1800s may well have chosen the device for this reason. By placing their operating corporations' shares in trust and receiving trust interest certificates in return, all conspirators placed themselves under the power of a mutually selected trustee.[114] For the duration of the trust, this trustee alone could vote the shares and thus control the constituent corporations.[115] Beneficiaries who changed their minds surrendered all unilateral power to break up the agreement in restraint of trade.[116] Although the antitrust acts forbid such trusts, voting trusts are still generally permitted for other

112. Note, however, that the many complex "tranches" of owners of interests in CDO trusts would be impossible or extremely difficult to implement in a corporation, LLC, or other business entity as the statutes authorizing these entities contemplate a fixed, relatively small number of ownership interests with relatively simple rights (e.g., a few classes of common stock and a few classes of preferred stock).

113. *In re* Marriage of Guinn, 93 P.3d 568, 572 (Colo. App. 2004) (explaining right to distributions only at discretion of trustees "mere gratuity deriving from . . . beneficence").

114. *See* BOGERT ET AL., *supra* note 9, §§ 121, 141 (discussing the selection of trustee(s), and chapter 9 discusses the power of trustee over trust property).

115. *Id.*

116. *See id.* § 181 (discussing the limited powers of beneficiaries over trust property).

purposes in corporate laws.[117] In the abstract, a group of shareholders who want to act in concert to coordinate voting control of a corporation could sign a contract and (perhaps) get specific remedy in case of breach; placing every party's shares in trust under the control of a trustee prevents unilateral defections from occurring in the first place.[118] In recognition of this greater effectiveness, corporation statutes generally require disclosure of voting trusts to all shareholders but do not require such disclosure of voting agreements.[119]

Using a trustee to operate a voting trust illustrates a wider and very powerful facet of trusts' flexibility: installing a trustee to serve as an *umpire* between competing actors. Perhaps most prominently, trustees frequently must decide how to make distributions between competing beneficiaries. The settlor of the trust may give as specific or as vague directions as she likes on the "rules" that the trustee should apply in making distributions. If she divides rights in a pool of bonds between a lifer and a remainderman, there is little discretion: the lifer will receive the periodic interest payments on the bonds, and after her death the trustee will distribute the bonds themselves to the remainderman. The settlor could simulate this simple trust with a corporation, having the firm buy the lifer an annuity and giving all shares of stock to the remainderman. At the other extreme, the settlor might instruct the trustee to "make payments, funded by either interest payments or sale of bonds, to my children and grandchildren who most need income, taking into particular consideration educational and health needs, but also including their happiness and well-being." It is impossible for a corporate entity to treat shareholders in such a disparate fashion: there is a powerful legal bias towards equal treatment of shareholders. Even the more flexible LLC is unsuited for a trust requiring so much umpiring, as it will be the owner members of the LLC either making the decisions or selecting managers to make the decisions.

Less frequently, trustees serve as umpires in a different role, mediating tensions between settlors and beneficiaries. The settlor, of course, can adopt a strict trust dictating almost any terms she likes, but she alternatively can give the trustee umpire substantial maneuvering room. Thus, for example, a trust can state that as default the trust shall distribute only 80% of income

117. *See* Comment, *Voting Agreement or Voting Trust? A Quandary for Corporate Shareholders*, 10 STAN. L. REV. 565, 565–66 (1958) (discussing shareholder voting agreements and voting trusts).

118. *Id.*

119. *See, e.g.*, DEL. CODE ANN. tit. 8, § 218 (2021) (requiring disclosure of voting trust with no such requirement for contractual voting agreement); MODEL BUS. CORP. ACT § 7.30 (1969) (AM. BAR ASS'N, revised 2016).

each year, in cases of "exceptional" need the trustee may distribute all income and even sell assets equal to 20% of income. In such cases, the settlor is paying the trustee in part to exercise some judgment and make exceptionally high distributions in times of exceptional need. Again, business entities simply are not suited to deploying agents in such umpiring roles.

Trustees as umpires have substantial overlap with another element of trust flexibility: trustee discretion in making distributions. Settlors can grant trustees as much discretion as they like in distributing trust income and principal.[120] Perhaps the most important sort is the discretion to vary distributions across beneficiaries. The examples given in prior paragraphs illustrate just how asymmetrically beneficiaries can be treated and how such divergent distributions can change over time. Once again, for business entities with strong equal treatment rules for all holders of classes of stock, such discretion in making distributions is infeasible.

Settlors do not always want to provide trustees with so much leeway, and trust law once again provides them unmatched flexibility to achieve their ends. The polar opposite of discretion is a fixed, detailed plan that the settlor wants executed to the letter, for years, decades, or even forever. Trust law enables such long-term planning without fear of later alteration by anyone. Even if the settlor is dead and every single possible beneficiary backs some proposed change to the operation of the trust, American trust law directs trustees to ignore the will of the beneficial owners and instead stay true to the directions of the original intent of the settlor under the famous *Claflin* doctrine.[121]

For companies, such fidelity to a fixed plan cannot be guaranteed. By default, a simple majority of shareholders can completely change plans and actions or dissolve the entity entirely and distribute the proceeds to creditors and shareholders.[122] Supermajority requirements make change more difficult but far from impossible, and so a unanimous coalition of owners can effectuate any conceivable alteration to a company. The power of trust law to maintain fidelity to a settlor's plan is all the more important given the demise of the Rule Against Perpetuities.[123] Whatever plans a settlor crafts for her dynastic trust can last for generations without end. [124]

120. Comment, *supra* note 114, at 566.

121. Claflin v. Claflin, 20 N.E. 454, 456 (1889). *Claflin* is widely followed in the United States, but not in other developed economies with the exception of some trust and tax havens like the Cayman Islands. BOGERT ET AL., *supra* note 9, § 1008.

122. MODEL BUS. CORP. ACT § 7.25.

123. *See* Kades, *supra* note 58, at 175–79.

124. *See* Kades, *supra* note 60 (manuscript at 2).

Corporations also can last forever but are always subject to a democratic change of course. For settlors interested in "dead hand" control over the use of their testamentary assets, there simply is no alternative to the trust.

Combining and generalizing many of these facets of flexibility, we can think of trusts as having the capacity to implement both beneficial interests and control along continua. Beneficial interests can range from rock-solid schedules of interest payments and principal distributions, to remote possibilities of receiving large or small sums, or anything in between. Trustees' powers of control can vary from entirely unfettered discretion to detailed mandates, and again pretty much anything between these extremes that a settlor might desire. Other entities simply cannot match this ability to finely tune the key twin elements of any legal entity, distribution of benefits and control.

This subsection has illustrated trust flexibility in the obvious, direct way, by enumerating the wide range of choices available to settlors. To drive home the point, we conclude in a slightly different vein with two general observations. First, federal and state legislatures have deployed trusts in a wide variety of contexts: Social Security benefits,[125] union employee benefit funds,[126] private pension plans,[127] and workers compensation funds.[128] This Article does not consider any of these uses; these diverse and divergent uses are cited here to highlight the flexibility of the trust as a legal tool. Second, federal tax treatment of trusts puts their extraordinary flexibility in high relief. Given the mutable, protean nature of trusts, deciding on how to tax them is inevitably difficult. It turns out that, depending on the settlor's choices, different trusts can literally be taxed in any of the major options under the tax code:

> It is possible to tax trusts in any way desired, and in fact under current United States federal income tax law, they are taxed sometimes as trusts (under special tax rules established for that form), sometimes as corporations, sometimes as partnerships, and sometimes they are simply ignored, depending on their particular attributes.[129]

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125. 42 U.S.C. § 401.

126. 29 U.S.C. § 186(c)(5).

127. Employee Retirement Income Security Act of 1974 § 403, 29 U.S.C. § 1103.

128. MYRON KOVE, GEORGE GLEASON BOGERT & GEORGE TAYLOR BOGERT, BOGERT'S THE LAW OF TRUSTS AND TRUSTEES § 246 (2022).

129. Hansmann & Mattei, *supra* note 105, at 478 (footnotes omitted).

This is a powerful demonstration of how the flexibility of trusts extends beyond their internal working, giving settlors significant power to pick and choose the tax rules that apply to their trusts.

III. TRUST PROBLEMS AND PROBLEM TRUSTS

This ability to select the way in which the federal government will tax their trusts is, of course, subject to abuse. This Article is far from the first to analyze how trusts can be and are deployed to socially undesirable ends. The objectionable uses previewed in Part I above and examined at greater depth later in Part III.B are only too well known. Before diving back into these specific examples, however, Part III.A briefly summarizes earlier work on the dark side of trusts and considers some general issues not raised in the literature.

A. Trust Problems

1. Nagging Concerns with Trusts

A handful of scholars have in passing noted a tendency for settlors to use trusts to avoid otherwise applicable laws. Sterk, for example, argues:

> A trust settlor has little reason to create a trust unless some obstacle—often a legal obstacle—makes it less practical for the settlor to use some other device to accomplish his objectives. Thus, it should not be surprising that, since their conception, settlors have often used trusts to avoid otherwise applicable legal rules.[130]

This may overstate the case a bit, as the trust is perfectly suited to socially valuable tasks such as providing support for underaged children or implementing a simple testamentary plan ("income from assets to my children for life, remainder to my grandchildren"). Still, this Article is broadly sympathetic with Sterk's jaundiced view of the overall social utility of trusts.

Schenkel shares this cynical perspective on trusts. He identifies the root cause of the problem as the ways in which trust law enables settlors, trustees, and beneficiaries to impose *externalities* on third parties such as creditors of the beneficiaries in the case of spendthrift trusts.[131] Although

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130. Sterk, *supra* note 50, at 1041.
131. Schenkel, *supra* note 18, at 184.

consistent with this Article's perspective, the externality concept does not capture the essence of the problem with trusts. An externality is not merely an act of A that harms B, as that would deem it an externality when A is willing to do a job for a lower wage than B—which is the quintessence of a well-functioning market. "Externality" is shorthand for "external to markets" and the defining feature is a missing market.[132] Pollution qualifies as an externality, for example, because high transaction costs due to a large number of parties and possibly bilateral monopoly produce such high transaction costs that the parties are unable to negotiate an agreement to minimize the costs of pollution.[133] Inability to negotiate due to transaction costs is an example of a missing market. It is unclear, however, what markets are missing in the context of trusts.

Bennett and Hofri-Winogradow seem to argue that the propensity for trusts to work so much mischief stems from the lack of any animating theory of the purpose of trusts.[134] This theory is generally at odds with the thesis propounded here. A legal tool without a purpose could simultaneously be completely inflexible and also incapable of serving anti-social ends, in which case it could not work the harms that trusts produce. The more flexible a tool, the more likely it can be put to bad as well as good uses. That is why this Article contends that excess flexibility, not lack of purpose, is at the core of the problem with trusts.

Hansmann and Mattei come closer to this Article's perspective when they note:

> Any jurisdiction that contemplates adopting the trust form . . . must be prepared to confront its tendency to facilitate avoidance of taxation - and, as well, of other forms of fiscal and regulatory law. Indeed, the protean nature of the trust makes it particularly well suited to efforts at fiscal and regulatory avoidance, and this has been among the reasons that the European civil law countries have been reluctant to adopt the form.[135]

As used here, "protean" is a synonym for flexible, and the authors tied this feature to the use of trusts to avoid laws of general application. They do not delve deeper into what makes trusts so flexible or what constitutes

132. RICHARD CORNES & TODD SANDLER, THE THEORY OF EXTERNALITIES, PUBLIC GOODS, AND CLUB GOODS 5 (2d ed. 1996).

133. *Id*.

134. Bennett & Hofri-Winogradow, *supra* note 18, at 706–07.

135. Hansmann & Mattei, *supra* note 105, at 478–79.

optimal flexibility of legal tools in general or trusts in particular. This Article takes that deeper dive: Part II.D above identified in some detail the features of trusts that make them so much more flexible than other entities, and this article revolves around the articulation of the optimal way to limit such a flexible entity.

2. Limitless Trusts Contrasted with Limited Corporations

Although this Article's focus and methods diverge from those of the scholarship cited in the previous subsection, it shares with them a deep skepticism about the overall social utility of any legal tool as malleable as the trust. Applying the foundational work of Hansmann and Kraakman, this Article takes asset partitioning as the key work done by entity law in general and trusts in particular. Legal entities, with the power to wall off assets in complex ways, are very powerful tools. They should be constructed with care and attention to proper uses and potential abuses.

To illustrate the exercise of such care, consider the design of two entirely different entities to service the very divergent needs of for-profit ("business") and non-profit corporations. The assets of business corporations belong to shareholders and so there is no wall between assets and shareholders. There is value in protecting creditors from grabby shareholders paying themselves without first paying the corporation's debts and so corporate law draws on other bodies of law and creates some of its own laws to provide optimal creditor protections.

In contrast, non-profit corporations have no shareholders because they have no real owners.[136] Instead of serving the pecuniary interest of shareholders, they instead serve some (usually disadvantaged) sub-population in a charitable fashion. Much for-profit corporate law makes no sense in the context of non-profits because they serve fundamentally different purposes and constituencies. It is worth noting that many donative trusts look much like *private charities* (a seeming contradiction in terms) in that they have no effective owners. Trustees are simply hired managers. Identifiable beneficiaries with non-contingent interests do resemble owners in important respects. In trusts (i) with contingent interests and/or (ii) that give trustees wide discretion in the distribution of trust income, however, beneficiaries have none of the attributes of ownership: no control and no right to generated income. This is a striking paradox: charitable entities designed to help the less fortunate share a deep structural similarity (lack of effective owners) with entirely non-charitable donative trusts invariably

136. HENRY HANSMANN, THE OWNERSHIP OF ENTERPRISE 238–39 (1996).

designed to bolster the entirely non-charitable project of furthering a bloodline with dynastic wealth. Although difficult to trace historically, it may well be the case that trust law has misguidedly given private donative trusts much of the special treatment conferred on non-profit firms due to their lack of ownership. The fact that one serves the public and the other serves private interests seems to have been lost on lawmakers. Finally, and most importantly, neither corporate regime (for-profits, with owners; non-profits, without) is flexible enough to serve as a substitute for the other. Each has a structure and a set of attributes that make it well-suited for its designed use. That structure and those attributes reduce the flexibility of each as a legal tool to pursue other purposes. Although reduced flexibility might sound to the uninitiated ear as a bad thing, this Article highlights the dangers of excessively flexible legal entities. There remains flexibility sufficient to use for-profit and non-profit corporations for all manner of novel uses, but they do have boundaries. Tellingly, trusts can easily mimic either a for-profit[137] or a non-profit corporation. The bottom-line intuition behind much of the concern about trusts is that the creation of a general purpose, maximally flexible legal entity is a prescription for trouble.

3. An Unnoticed Inefficiency of Trusts

Before returning to the list of troubling trusts previewed in Part I, there is one more important but heretofore unremarked inefficiency inherent in many trusts: beneficiary interests are inalienable, a generally undesirable state of affairs. Inalienable trust interests arise for two main reasons. The terms of the trust may directly dictate inalienability—the spendthrift and asset protection trusts introduced in Part I.C. In addition, many trust interests are effectively inalienable because they are too contingent or inchoate. Even a simple trust apportioning income from a pool of assets as simply as "to my children for life and then to my grandchildren" creates highly contingent interests. The children's annual income will depend on their life expectancy and the life expectancy of their siblings—whichever child lives the longest will receive 100% of the trust income for the remainder of her life. There is even greater variability in the income of the grandchildren—indeed, some of them may be unborn. Any interest holder wishing to sell her interest, e.g., to fund education or start a business, will find few if any buyers at attractive prices, and if someone is interested, they will pay a steep discount to account for the uncertainty of the future stream of trust benefits. Even more uncertain and hence effectively impossible to

137. DEL. CODE ANN., tit. 12, § 3801(i) (2022).

alienate are trust beneficial interests in which payments are made to beneficiaries at the sole discretion of the trustee. Such interests are generally unmarketable.

The traditional view, however, has been that trusts *solve* inalienability problems rather than create them.[138] Merrill and Smith note that "the trust combines a highly simplified title in the underlying assets with a significant degree of flexibility in designating the beneficial uses of those assets."[139] The idea is that no matter how complex, contingent, and inchoate the *beneficiaries'* interests in the income from a trust's assets, the trustee, by virtue of her fee simple *legal* title, may sell any asset (and invest the proceeds in an alternative). Thus, any asset placed in a trust is freely alienable, and can be sold to the highest bidder—its highest and best use. This is the definition of efficiency. To use a common example, a residential house placed in a trust to benefit family members for a number of generations may prove to be inefficient if (a) the neighborhood evolves in the direction of commerce rather than residential use, or (b) some family members move away. In either case, if the beneficiary family members do not hold the house in trust it may prove difficult or impossible to sell the house. A family member who enjoys living in the house and does not move away will be able to block any sale to the highest value user, either another residential user or a commercial user. If the house is in trust, however, the trustee can sell the house to the highest bidder, invest the proceeds in other assets, and pay (more) income to the beneficiaries.

All true as far as it goes. There are, however, two levels of potential inefficiency in trusts. The previous paragraph showed how trusts preserve the transferability of *specific assets* regardless of the complexity and contingency of the beneficial interests. Trusts, however, do not solve a second level of inefficiency: inalienability of those beneficial interests ("cash flow" inalienability). Indeed, per the first paragraph of this subsection, trusts may foster such inefficiency by giving rise to a large number of contingent, inchoate interests. Although perhaps less vivid and intuitive than the inefficiency of inalienable "hard" assets like real estate or a painting, inalienable rights to a stream of cash flows produce exactly the same inefficiency: they do not get into the hands of the person valuing them the most. Someone 30 years old with trust income of $5,000 a year for life

138. Merrill & Smith, *supra* note 73, at 18. See Carla Spivack, *Democracy and Trusts*, 42 ACTEC L.J. 311, 315 (2017), for a compelling argument that Numerus Clausus should apply to beneficial trust interests.

139. Merrill & Smith, *supra* note 73, at 18.

might wish to sell those cash flows for $70,000,[140] e.g., to make a down payment on a house or to start a business. If this income comes from a spendthrift trust, however, she will not be able to sell her interest to a buyer who prefers the stream of $5,000 annual payments to a lump sum of $70,000 today. To give one more example, a beneficiary with a highly contingent interest, say an estimated 0.1% chance of inheriting $100 million dollars in the next year, might well want to sell this lottery-like interest for $50,000.[141] Although this is relatively straightforward compared to some of the contingencies cited earlier in this subsection, nonetheless, it may be hard to find a someone willing to buy this risky "asset," and of course a spendthrift interest would render it absolutely inalienable.

Thus, in trusts, spendthrift or not, settlors create many unmarketable cash flow rights. Lest readers think the examples in the previous paragraph are quaint, there is powerful and pervasive evidence that people devote significant time, effort, and money to arranging their affairs so that they receive money when they need it and sock it away for a rainy day when they don't. One of the most widely cited principles of household economic planning, the life-cycle theory of saving, establishes that workers tend to borrow when young, save in their middle years, and then dissave to fund their retirement years.[142] The gargantuan collateralized debt obligation (CDO) industry creates entirely novel patterns of cash flows ("tranches") from standard assets like mortgages and credit card loans, and markets each tranche to the subset of investors that have a preference for a particular payment schedule, rate of return (reflecting risk), and other factors.[143]

The lesson is clear: rights to streams of income over time (cash flows) are an enormously important part of developed economies. Although trusts do facilitate the alienability of hard assets, they simultaneously can create large numbers of cash flows that are either absolutely or practically inalienable. These efficiency costs might well more than offset the gains

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140. At a typical interest rate of 4% and a life expectancy of 80, the expected value of this interest is about $107,500 using standard present value calculations. Given the uncertainty about how long the beneficiary will live and the riskiness of the trust assets (and hence possibility that payments will cease prematurely), the $70,000 valuation posited used above employs a higher interest rate, 7%, to reflect these risks.

141. The simple expected value of this contingent interest is $100,000 (.001 * 100,000,000). Given uncertainty about the *estimated* 0.1% probability of a payoff, purchasers will heavily discount the price that they are willing to pay. This is why the hypothesized price in the text is $50,000, not $100,000.

142. See Franco Modigliani, *The Life Cycle Hypothesis of Saving, the Demand for Wealth and the Supply of Capital*, 33 SOC. RSCH. 160, 160–61 (1966), for an early synthesis of the life-cycle hypothesis; see RUDIGER DORNBUSCH, STANLEY FISCHER & RICHARD STARTZ, MACROECONOMICS 339–43 (9th ed. 2004), for a basic introduction.

143. *See infra* notes 186–92 and accompanying text.

trusts offer by making hard assets alienable. In addition, the demise of the Rule Against Perpetuities means that trusts can render the cash flows from large "dynastic" trusts inalienable *forever*. The ability to create dynastic trusts may satisfy wealthy settlors' desire for unending bloodline status, but they impose permanent costs on all cash flows generated by whatever wealth the trust contains.

There is one final, telling perspective on the efficiency costs of placing wealth in trusts: it can make the *market* value of wealth virtually disappear in an instant. A settlor who places $10 billion of corporate stock in a dynastic family trust that makes contingent, discretionary payouts to only a small set of descendants—those most likely to raise family status[144]—in the blink of an eye has converted that $10 billion in marketable wealth into an effectively infinite number of highly contingent future interests. Living descendants likely will be unable to sell their interests, and of course unborn descendants cannot. Although the stock comprising the trust *res* remains alienable at the discretion of the trustee, the cash flows generated by $10 billion, whether in the original stock or in other assets obtained on sale of the stock, are entirely inalienable. If the settlor has any concerns at all despite this practical bar, she of course may insert a spendthrift provision affirmatively barring sale of trust interests. This shows that excessive division of rights in cash flows creates an *anti-commons* problem: when property rights are divided up into too many small pieces they may lose most of their value and, moreover, the cost of re-assembling them into pieces of useable dimension (in the case of cash flows this means alienable) may be prohibitively costly.[145]

B. Problems Trusts

The problems in the previous subsection extend to many trusts. Much of the costs imposed by trusts, however, vary significantly with their purpose. To illustrate this phenomenon and round out the argument that trusts are too flexible for our own good, this subsection revisits the abusive trusts introduced in Part I. We dissect each of these types of trusts in two steps. First, we summarize the costs imposed and why these costs appear to outweigh any benefits. The analysis covers both efficiency and fairness costs. The lesson of this part of the analysis is that there is little commonality in the efficiency and fairness costs imposed by these trusts.

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144. *See* Kades, *supra* note 60, at 2.

145. *See* Michael A. Heller, *The Tragedy of the Anticommons: Property in the Transition from Marx to Markets*, 111 HARV. L. REV. 621, 622 (1998); James M. Buchanan & Yong J. Yoon, *Symmetric Tragedies: Commons and Anticommons*, 43 J. L. & ECON. 1, 4–5, 12 (2000).

Thus, addressing problem trusts by focusing on the type of costs that they impose appears unfruitful.

Second, we identify the dimensions of flexibility that make a private trust unique among legal entities in its ability to accomplish these anti-social ends. The takeaway, again, is that there is considerable heterogeneity in the types of flexibility that enable each undesirable type of trust. This means that it would be difficult to fix the problem with trusts by reducing the range of choice for a limited number of trust features.

1. Oligopolistic Trusts

As noted in passing earlier,[146] the normative case against using trusts to restrain trade and garner economic rents is unassailable. As a matter of efficiency, oligopolies and other restraints of trade impose the famous "deadweight loss" triangle inculcated into Econ 101 students all over the world.[147] This cost of oligopoly does not inure to the benefit of industry trust oligopolists, but rather is simply the value of the previously feasible transactions lost at the margin due to the higher price.[148] There is also a strong fairness case against restraints of trade, as they generally inure to the benefit of those who own capital, and capital (wealth) inequality is much greater than even today's high level of income inequality.[149] There are no offsetting efficiency or fairness benefits of oligopoly.

Although the antitrust acts ban agreements in restraint of trade regardless of the entity or contracts utilized as a means to that end,[150] the trust remains a relatively attractive tool for would-be oligopolists attempting to limit supply and raise prices. By placing their respective shares in a voting trust, oligopolists can powerfully *precommit* to have those shares automatically vote to limit each member company's production. Given the inherent instability of oligopolies and the continuous incentives for members to cheat and produce more than their quota,[151] the ability of the trustee to act as an umpire, monitor for cheating, and sanction it (per terms in the trust agreement) is extremely useful. Finally, trust law helps colluders stick to a fixed plan for any period of time.

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146. *See supra* note 30 and accompanying text.

147. MAS-COLELL, WHINSTON, & GREEN, *supra* note 30, at 387.

148. *Id.*

149. JULIANA MENASCE HOROWITZ, RUTH IGIELNIK, & RAKESH KOCHHAR, PEW RSCH. CTR., MOST AMERICANS SAY THERE IS TOO MUCH ECONOMIC INEQUALITY IN THE U.S., BUT FEWER THAN HALF CALL IT A TOP PRIORITY 19 (2020), https://www.pewresearch.org/social-trends/2020/01/09/trends-in-income-and-wealth-inequality/.

150. Sherman Act, 15 U.S.C. §§ 1–7 (2018); Clayton Act, 15 U.S.C. § 13 (2018).

151. JEAN TIROLE, THE THEORY OF INDUSTRIAL ORGANIZATION 205–09 (1988).

2. Spendthrift and Asset Protection Trusts

The normative analysis of spendthrift trusts is much more difficult than oligopolies. Spendthrift trusts for children who settlor parents know to have destructive spending tendencies (anything from budget-busting shopping sprees to addictions to illegal and relatively expensive drugs) have clear benefits. Settlors of trusts with such beneficiaries are using their intimate knowledge of beneficiaries' various diminished capacities to protect the donees from themselves. This is common and socially useful behavior, sanctioned and encouraged by a legal system that has a wide variety of doctrines to protect actors with diminished capacity, e.g., inability of those lacking capacity to make enforceable contracts,[152] the wide powers parents have over their children's lives until they reach the age of maturity,[153] and laws of guardianship and conservatorship to protect adults lacking the capacity to manage their own affairs.[154]

Settlors, however, frequently create spendthrift trusts lacking any semblance of protecting the vulnerable. In particular, decedents routinely use them in testamentary trusts that govern the distribution of benefits from their estates *even when no beneficiary suffers from any sort of disability*. Additionally, testamentary spendthrift provisions can and often do apply to unborn generations—where there can be no knowledge of disabilities. The fact that settlors choose spendthrift trusts suggests that creating such trusts is of some utility to the settlor herself.

For beneficiaries, spendthrift trusts are a decidedly mixed blessing. On the one hand, spendthrift provisions will come in very handy for those beneficiaries who unexpectedly become liable for a large judgment, e.g.,

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152. *See* JOSEPH M. PERILLO, *Avoidance and Reformation, in* 7 CORBIN ON CONTRACTS 2, 2 (rev. ed. 2002).

153. WALTER J. WADLINGTON, RAYMOND C. O'BRIEN, & ROBIN FRETWELL WILSON, FAMILY LAW IN PERSPECTIVE 153 (4th ed. 2018).

> Consistently, courts have held that so long as a parent adequately cares for his or her children, there is no reason for the state to inject itself into the private realm of the family, or to further question the ability of that parent to make the best decisions concerning the rearing of that parent's children.

154. Guardianships place individuals lacking any capacity to act on their own behalf ("wards") under the control of guardians who manages all of the ward's affairs; conservatorships assist those with partial capacity by having a conservator manage difficult aspects of their lives, e.g., managing the finances of an elderly person struggling with only some cognitive demands. State laws on guardianship vary considerably. *See, e.g.*, Joseph P. Buttiglieri, *Guardianship and Conservatorship*, MICH. BAR J., Jan. 2016, at 42, 42–43; John C. Judge, *New Chapter In Idaho's Guardianships: Efforts of the Supreme Court Committee to Improve the Practice*, ADVOCATE, June/July 2017, at 38, 38; Christy Molzen, *You are Invited to Comment on the Proposed Guardianship and Conservatorship Act*, J. KAN. BAR ASS'N, June/July 2001, at 33.

due to committing a tort for which they lack insurance.[155] On the other hand, spendthrift provisions disempower beneficiaries from executing valuable transactions such as borrowing money to start a business and negotiating a lower interest rate by pledging the trust assets as collateral.[156] This is simply another manifestation of the inefficiency of the many inalienable interests created by trusts that we examined above in Part III.A.3.

Moving beyond the beneficiaries, spendthrift trusts have negative effects on third parties: beneficiaries' creditors. Assets in spendthrift trusts fund beneficiary consumption but are unavailable to satisfy beneficiary debts.

This raises the unedifying prospect of a beneficiary who carelessly or even intentionally harms someone, suffers a tort judgment, and yet continues to live the high life while leaving her injured victim uncompensated. In theory, contract creditors can protect themselves by doing due diligence and negotiating terms premised on the unavailability of trust assets to satisfy claims.[157] In practice, however, this story may be unrealistic for guileless creditors. Laborers of modest means and limited knowledge of the law and business may be fooled. For example, a caterer may agree to feed a large wedding party at a mansion inhabited by a spendthrift trust beneficiary under the assumption that anyone who lives in such a house will pay for the food and service. Note that if the settlor did aggressive planning, the house can be owned by the trust rather than the beneficiary and so the caterer will not be able to file any sort of lien against the house as a means of extracting payment.[158]

As in many other situations, the demise of the Rule Against Perpetuities has extended all of the costs of spendthrift trusts from a few to an unbounded number of generations. Note that the benefits of spendthrift trusts, rooted in the settlor's specific knowledge of some beneficiary's lack

155. In theory, contract creditors can bargain with knowledge that their counterparty enjoys income from a spendthrift trust. Yet pinning down the income sources of customers visibly engaged in conspicuous consumption is not free, and the case books are replete with honest creditors shafted by spendthrift trust beneficiaries. *See, e.g.*, *Cong. Hotel Co. v. Martin*, 143 N.E. 838, 839 (Ill. 1924) (stating beneficiary of trust yielding income of $171,000 a year defeated claims by hotel and clothes makers); Kilroy v. Wood, 49 N.Y. Sup. Ct. 636, 638 (1886) (explaining trust assets of spendthrift trust protected from all creditors of beneficiary "gentlemen" with classy friends who are members of fancy "clubs").

156. See HERNANDO DE SOTO, THE MYSTERY OF CAPITAL 46–50 (2000), for a very influential and celebrated argument that one of the main benefits of private property and clear ownership is its utility in helping owners secure loans for entrepreneurship.

157. Such a term falls easily within the capacious bounds of the freedom to contract. *See* Merrill & Smith, *supra* note 73, at 1.

158. This is a powerful example showing that in substance a trust is a legal entity.

of capacity, are not similarly multiplied across multiple generations like the costs: known beneficiaries of full legal capacity and unborn beneficiaries most likely of full capacity are in no need of infantilizing spendthrift trusts.

The case in favor of spendthrift trusts, then, must be that:

> (i) the value of permitting settlors to do this confers some social benefit, plus
>
> (ii) the possible net value to beneficiaries (asset protection more valuable than the freedom to alienate trust interests) exceeds
>
> (iii) the patent inefficiency of all those inalienable trust income flows, and
>
> (iv) the inefficiency and unfairness of creditors going unpaid while beneficiaries live well off trust income.

There is no definitive way to determine whether benefits or costs are greater. That said, the empirical evidence against the first benefit and the mixed nature of the second suggest benefits are modest at best. In contrast, the costs of inalienability are generally thought to be significant, and the unfairness costs of stiffing unsophisticated contract and non-consenting tort creditors seems significant. The balance of the evidence suggests that spendthrift trusts are socially undesirable on both efficiency and fairness grounds.

The case is all the stronger against asset protection trusts (APTs)—self-settled spendthrift trusts in which the settlor names herself as the beneficiary of the trust.[159] Until trust industry lobbying beginning in the 1990s, such devices were universally prohibited.[160] In 1987, a leading treatise flatly stated that APTs were universally unenforceable, and gave reasons:

> To hold otherwise would be to give unexampled opportunity to unscrupulous persons to shelter their property before engaging in speculative business enterprises, to mislead creditors into thinking that the settlor still owned the property since he appeared to be receiving its income, and thereby work a gross

159. Hirsch, *supra* note 52, at 2687–90.
160. *Id.* at 2685.

> fraud on creditors who might place reliance on the former prosperity and financial stability of the debtor.[161]

The policy case against APTs merits some fleshing out. For APTs, the main benefit of spendthrift trusts—benevolent settlors concerned with close ones lacking legal capacity—disappears. Given a settlor's choice to establish such a trust for herself instead of another, we can infer that she values asset protection over free alienability. Such settlors apparently are worried that their "future selves" will spend improvidently (e.g., gamble excessively) and thus have a reasonable ground for putting assets in an APT. Based on these observations, Hirsch makes a spirited defense of APTs.[162]

The potential costs to creditors, however, are much higher. Settlors can set up APTs in anticipation of trouble. As noted earlier, there are case law references to physicians and others placing assets in APTs in order to protect them from any malpractice claims that might exceed their insurance coverage.[163] One can imagine others at risk of tort judgments similarly establishing APTs. In addition to the unfairness to tort creditors, APTs present a real risk of undermining the valuable deterrence provided by tort liability.

APTs must be irrevocable to confer protection from creditors,[164] but settlors often can find very compliant trustees (e.g., lawyers or banks to whom they or their businesses steer significant other lucrative transactions) who will (quietly) do the bidding of the settlor/beneficiary. When trustees are puppets of the settlor or beneficiary, the trust is a sham and the assets, in practical terms, are owned directly by the puppet-master. APT settlors then can garner all of the advantages of asset protection without sacrificing alienability one whit.

Limitlessly manipulable, completely lacking in the main justification for spendthrift provisions, and posing serious risk to tort and unsophisticated contract creditors, the APT is simply a policy gaffe unjustifiable on any sound public policy basis.

Spendthrift and AP trusts rely heavily on a single special feature of trusts, its ability to partition assets into just about any configuration that

161. GEORGE T. BOGERT, TRUSTS 155–56 (6th ed. 1987).

162. Hirsch, *supra* note 52, at 2691, 2702–07.

163. *See supra* notes 54–55 and accompanying text.

164. ELIZABETH DELEERY, GEORGE GLEASON BOGERT, GEORGE TAYLOR BOGERT & AMY MORRIS HESS, BOGERT'S THE LAW OF TRUSTS AND TRUSTEES § 112 (2022).

creative scriveners can imagine.[165] These devices in effect partition a beneficiary's assets into two separate boxes: one "regular" box available to creditors and a new, separate box unavailable to creditors. Trust law enables people to move assets between these (and other) legal boxes with little if any cost.

3. Dynastic Trusts

The policy case against dynastic trusts seems even stronger than the case against APTs. Perhaps the single most powerful piece of evidence is that no one has offered even the semblance of a policy justification for dynastic trusts. Industry agents (trust lawyers and bankers) convinced state legislatures to abolish the Rule Against Perpetuities for the self-serving purpose of attracting wealthy clients to do their wealth management and estate planning in the jurisdiction.[166] Like any race to the bottom, this is a transparent prisoners' dilemma: although it may have been individually rational, collectively it is bound to fail.

Moreover, authorizing dead hand control of wealth *forever* imposes costs both within families and at a macro level.[167] A dynastic trust can dole out money on any schedule and for any reasons—designed at some earlier date to satisfy the dynastic urge of a long-dead settlor. Dynasty trusts invariably have spendthrift provisions and so, even if all beneficiaries could assemble and agree to rejigger interests in the trust, they could not, and the existence of unborn beneficiaries (existing in dynastic trusts by definition) makes unanimous agreement to amend a trust impossible. At a societal level, dynastic family wealth will calcify record levels of wealth inequality and reduce intergenerational socioeconomic mobility below its already low current level.[168] Dynastic trusts place American society at considerable risk of returning to a "New Feudalism" in which a relatively small number of spectacularly wealthy families enjoy outsized power and influence for

165. This fact buttresses Hansmann and Kraakman's hypothesis that the essence of entity law is asset partitioning. Hansmann & Kraakman, *supra* note 93, at 390.

166. *See generally* Robert H. Sitkoff & Max M. Schanzenbach, *Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes*, 115 YALE L.J. 356 (2005) (discussing states' abolition of the Rule Against Perpetuities, the connection with federal and state tax law, and asset protection trusts).

167. See Kades, *supra* note 60, at 40–41, for a detailed analysis of these social costs imposed by dynastic trusts.

168. *See* HOROWITZ ET AL., *supra* note 149, at 14 (income and wealth inequality); Raj Chetty, Nathaniel Hendren, Patrick Kline, & Emmanuel Saez, *Where is the Land of Opportunity? The Geography of Intergenerational Mobility in the United States*, 129 Q. J. ECON. 1553, 1554 (2014) (stating that children in some areas of the United States have little opportunity for socioeconomic mobility).

generations without end. Such a prospect is patently inconsistent with America's founding principles.

Dynasty trusts rely heavily on two entity features unique to trusts. First, only trusts empower dynasty founders to divide trust income between their progeny asymmetrically, in ways that maximize family status. Picking and choosing to fund those descendants with the greatest potential to maintain (and increase) the bloodline's standing in the social pecking order is simply unachievable for business entities like corporations or LLCs. Second, trusts alone permit settlors to establish a fixed and *forever unamendable* plan for the payout of trust income for generation after generation. To state this in more direct terms, trusts alone can effectuate dead hand control of asset income forever. As noted earlier, business entity plans are always amendable.[169] Dynasty trusts also benefit from the trustee's role as an umpire among competing interests, duty bound to select among competing beneficiaries based on the settlor's "original intent."

4. Tax Avoidance: GRATs

Recall in Part I.D.3 that grantor-retained annuity trusts (GRATs) exist solely to enable wealthy settlor/testators to avoid transfer taxes by exploiting their superior information about the likelihood that the assets placed in the trust will appreciate—extensive research revealed no other reason to create a GRAT.[170] The information asymmetry between the taxpayer and the government is real and unavoidable, but that does not mean that the polity should tolerate a trust that exploits this advantage for private gain at the expense of the public fisc. Legal devices with no purpose other than the avoidance of taxes are by definition inefficient: taxpayer expenditures on lawyers and finance professionals abuse are inefficient deadweight losses, as are government expenditures on trying to ferret out cases of taxpayers going too far. Like virtually all sophisticated tax avoidance stratagems, GRATs enable the wealthiest taxpayers to avoid significant portions of the tax burden that duly enacted legislation deems their fair share. The shortfall inevitably results in higher taxes on (or lower services for) less affluent taxpayers—either today or in the future. This makes a strong case for the unfairness of GRATs.

It is not possible to mimic a GRAT via use of a corporation, LLC, or other business entity. Attempting such an approach, the settlor would create New Corporation, have this new entity promise to pay her an annuity over

169. *See supra* note 122 and accompanying text.
170. MCDANIEL ET AL., *supra* note 65, at 757.

coming years equal to the current value of the stock in Old Corporation that is expected to appreciate, and then give the shares of New Corporation to her children or other beneficiaries.[171] If the present value of the annuity payments equals the unappreciated value of the stock, New Corporation has a net value of zero (annuity liability equals value of only asset, stock in Old Corporation), and so the gift incurs no transfer tax liability.

There is, however, a major shortcoming of this attempt to simulate a GRAT with a corporation instead of a trust: there is no trustee to prevent the beneficiaries from violating the settlor's intent for the term of the annuity. Stock ownership would give beneficiaries full voting control of the corporation and they could, e.g., sell all of the shares of Old Corporation before they appreciate, pocket the money, and gamble that the settlor, their benefactor, would not sue them for the value of the annuity. Even if the settlor did sue and win, she may not be able to collect, e.g., if the beneficiaries have lost the money at the casino. In a slightly less brazen scenario, impulsive and impatient beneficiaries could sell the shares after they appreciate only half as much as expected, pay off the annuity out of the proceeds, and pocket the (partial) appreciation of the shares.

As an alternative to using corporations to effectuate a GRAT, a settlor could try proceeding without any entity at all. She would draft an instrument of gift with two main clauses. The first provision would grant herself a stream of periodic payments equal in present value terms to the claimed current (low) value of the stock. The second provision would dictate the transfer of title to the shares to the beneficiaries immediately, but reserve voting power in the settlor until she receives all payments specified in the first clause. There might be some corporate law problems with separating voting rights from ownership, but those likely are surmountable.[172] The bigger problem is Numerus Clausus: the interests created by this gift do not fit into any of the limited permissible categories of property.[173] The settlor has something that bears a faint likeness to a term of years or a life estate, but the periodic payments she receives are not equal to the periodic income of the stock. Further, in addition to periodic payments the settlor has retained valuable voting rights in the shares for a number of years. The attempt to mimic a GRAT without use of any entity requires settlors to invent a new type of property interest, but it is precisely

171. If the settlor postponed transfer of the shares in New Corporation, the beneficiaries would receive the value of the Old Corporation shares *post-appreciation*, subjecting the large capital gain to transfer taxes and thus defeating the purpose of a GRAT.

172. *See, e.g.*, MODEL BUS. CORPS. ACT § 7.22(d) (revised 2016) (irrevocable proxies).

173. Merrill & Smith, *supra* note 85, at 3.

such innovations that Numerus Clausus forbids. [174] As Merrill and Smith point out, this is the reason that such interests are always embedded within a trust managed by a trustee having full legal title to the assets (here, stock).[175]

This Numerus Clausus problem tells us that trusts' ability to define beneficial interests in property of any conceivable shape and size is the piece of the GRAT puzzle that an entity-less approach cannot emulate. In addition, the trustee's *sui generis* role as an umpire, along with the ability of the settlor to specify a fixed, unchanging plan, are essential elements for GRATs that corporate law simply cannot simulate. Thus, the trust stands as the only tool capable of creating a working GRAT—and imposing the concomitant costs outlined at the beginning of this subsection.

5. Institutional Concerns with Private Trusts

For all of the problematic donative trusts discussed above, there are two asymmetries that may mean that the true downside is even larger than simple observation suggests. First, such trusts generally operate outside public view. Thus, it is impossible to know the number of asset protection or dynasty trusts in place, and difficult to know what sorts of innovative provisions are appearing in these invisible legal entities. The extent and quality of such trusts do become known to some extent through litigation and through information channels such as lawyers' journals and continuing legal education, but this can take years. Under a permissive rule for trusts, these extra years delay legal change and thus impose greater costs. Second, the political economy of trusts further biases outcomes regressively—i.e., unfairly. All four of the undesirable major trust innovations described above are extremely valuable to the small slice of the population holding great wealth, by (i) increasing returns to oligopolistic capital; (ii) facilitating frustration of creditors of wealthy beneficiaries of spendthrift trusts; (iii) establishing family dynasties; and (iv) minimizing transfer taxes on estates of the wealthiest slice of the population.[176] These patrician trusts are of little use to the vast majority who lack great wealth, and, moreover, the cost of these trusts (uncompensated creditors; lower socioeconomic mobility; higher taxes) fall largely on them. One of the strongest hypotheses of political theory is that highly motivated small groups ("special interests") frequently prevail over the interests of the vast

174. *Id.* at 18.

175. *Id.*

176. *See* HOROWITZ ET AL., *supra* note 149, at 14.

majority of the citizenry—especially when the small group is well-funded.[177] There is ample evidence that the wealthy have spent billions over the last few decades seeking lower taxes and greater flexibility for their trusts.[178] In terms of our model, this means oligopolies, spendthrift trusts, dynastic trusts, and tax-avoidance trusts, like the GRAT, impose greater costs than a simple calculus likely tallies.

IV. REFORM: A LIMITED MENU OF PERMISSIBLE TRUSTS

The preceding section offers evidence in support of this Article's key premise: innovative trusts impose more costs than benefits. In addition, it provides some guidance in applying the theory of optimal flexibility outlined in Part II.A above. The multiple nugatory purposes observed mean that it is not particularly helpful to simply ban one or a few uses. In addition, the analysis in the preceding section did not identify one or a small number of dimensions of flexibility implicated in all or most undesirable trust innovations; rather, the facets of trust law enabling these socially costly uses varied widely from case to case. Part II.A concluded that when costly novel uses of a flexible tool like trusts outweigh beneficial innovations, and variegated dimensions of the tool facilitate these undesirable uses, more fundamental reform is in order: (i) the abolition of the flexible tool for general purposes, along with (ii) the creation of similarly flexible tools limited to identified positive uses, and (iii) the creation of strictly limited tools for undesirable uses—with the restrictions sufficient to prevent all or most of the known costs of the unrestricted flexible tool.

The first arm of this reform no doubt sounds radical. Trusts are ubiquitous in the American legal landscape, and to bar their current unlimited use is indeed a revolutionary change in the law of trusts. Note, however, that much of what this proposal takes away with one hand (the current law of trusts, useable for almost any purpose) it gives back with the other. This proposed reform provides those current categories of significant social value with essentially the same tool—limiting such flexibility, of course, to these limited ends. Even undesirable uses are retooled, though

177. MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS 144 (1965).

178. MICHAEL J. GRAETZ & IAN SHAPIRO, DEATH BY A THOUSAND CUTS: THE FIGHT OVER TAXING INHERITED WEALTH 239–53 (2005) (documenting expenditures aimed at repealing the estate tax); CHUCK COLLINS, THE WEALTH HOARDERS: HOW BILLIONAIRES SPEND MILLIONS TO HIDE TRILLIONS 71–78 (2021) (tracing how very wealthy families use trusts, along with other devices to avoid taxes and regulations).

with a much less protean apparatus designed to denude them of the power to impose costs on society.

The second arm of the reform recommends creating a very flexible device for clearly positive recent innovative uses of trusts. The primary example is *financial* trusts. As noted earlier, recent experience has revealed two very productive trust law innovations over the last few decades: CDOs and mutual funds.[179]

Given that nearly half of American households hold them,[180] readers likely have much greater knowledge of mutual funds. These tools of financial intermediation (linking up investors and borrowers) buy up large pools of assets (e.g., stocks, bonds, real estate) and sell tiny fractional interests in the pool to investors.[181] This mechanism helps investors of modest means buy a wide range of assets with minimal transaction costs and, perhaps most importantly, enables them to assemble very well-diversified wealth portfolios.[182] Competition and cutting out various middlemen yields gains that the two sides split in terms of more attractive interest rates for both, along with more favorable contract terms on issues of particular concern to each side. Expanding financial intermediation (more and larger links between investors and borrowers) offers considerable benefits to both sides of mutual fund transactions, investors on one side and business enterprises on the other.[183] Mutual funds themselves are a very low-cost middleman. Mutual funds' preferred legal "container" for the assets in each of their investment vehicles is the trust, due to its great flexibility. There was virtually no notion of a business corporation, let alone a share of stock when the trust evolved in the late Middle Ages, but creative lawyers in the 20th century decided that the infinitely flexible trust best

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179. *See* Langbein, *supra* note 72, at 183–84.

180. *Share of Households Owning Mutual Funds in the United States from 1980 to 2020*, STATISTA RSCH. DEP'T (June 28, 2022), https://www.statista.com/statistics/246224/mutual-funds-owned-by-americanhouseholds/ (showing 45.7% of U.S. households own mutual funds).

181. See U.S. Securities and Exchange Commission, *Mutual Funds and ETFs, A Guide for Investors*, https://www.sec.gov/investor/pubs/sec-guide-to-mutual-funds.pdf, for an overview of mutual funds

182. RICHARD BREALEY, STEWART MYERS, & FRANKLIN ALLEN, PRINCIPLES OF CORPORATE FINANCE ch. 18 (13th ed. 2020) ("Portfolio Theory and the Capital Asset Pricing Model.").

183. The importance and value of financial intermediation in modern, deeply capitalized economies, is a generally accepted fact. *See, e.g.*, BENTON E. GUP, BANKING AND FINANCIAL INSTITUTIONS: A GUIDE FOR DIRECTORS, INVESTORS, AND COUNTERPARTIES 23–25 (2011); Franklin Allen & Anthony M. Santomero, *The Theory of Financial Intermediation*, 21 J. BANKING & FIN. 1461, 1461–63 (1998).

served their needs.[184] Advanced economies have enjoyed large financial gains due to this innovative deployment of trusts.[185]

Collateralized debt obligations (CDOs),[186] though having fundamental similarities to mutual funds, are more complex. Like mutual funds, CDOs enable virtually any institution or person to invest in pools of large numbers of modest debt contracts (e.g., home mortgages; car loans; credit card receivables).[187] The major difference is that investors in mutual funds are all treated equally except for the scale of their investment (the size of their fractional interest in the pool of assets), while modern CDOs typically offer an array of different tranches, each with its own risk/return profile and repayment term.[188] This market, which began with a single small federal agency GNMA (Government National Mortgage Association, usually referred to as "Ginnie Mae") in 1968,[189] has mushroomed into one of the world's largest financial realms, with trillions of dollars of such securities outstanding and billions or trillions more issued each year.[190] Like mutual funds, financial engineers decided that the venerable, medieval trust, ever so flexible, was the perfect entity to hold CDO assets. Langbein identified their primary reason: trust law's licensing of "freedom to carve beneficial interests without regard to traditional classes of corporate shares."[191]

CDOs have their critics; some blame them for playing a major role in the financial crash of 2007.[192] Note, however, that the objectionable aspects of CDOs (failure to monitor quality of underlying assets; failure to disclose

184. *Id.*

185. *Id.*

186. Financial industry terminology seems to change every decade and thus can be ambiguous and even opaque. The original form of CDOs was mortgage-backed securities (MBS). When the financial industry began to pool other assets, e.g., car loans and credit card balances, the industry adopted the more general term asset-backed securities (ABS). As investment bankers expanded into other underlying debt instruments, such as bank loans and corporate bonds, the industry adopted the generic moniker collateralized debt obligations (CDOs).

187. See Janet Tavakoli, *Introduction to Collateralized Debt Obligations*, TAVAKOLI STRUCTURED FIN., https://www.tavakolistructuredfinance.com/cdo/ (last visited, Feb. 8, 2023), for an accessible, brief introduction to CDOs. See DOUGLAS J. LUCAS ET AL., COLLATERALIZED DEBT OBLIGATIONS, STRUCTURE AND ANALYSIS (2nd ed. 2006), for a more comprehensive treatment.

188. *Id.*

189. *Our History*, GINNIE MAE, https://www.ginniemae.gov/about_us/who_we_are/pages/our_history.aspx (last visited Feb. 2, 2023).

190. The outstanding amount of home mortgage-backed securities alone back in 2011 was $11.45 trillion. Richard Dorfman, SEC. IND. & FIN. MKTS. ASS'N, MORTGAGE-BACKED SECURITIES FACT SHEET 1 (2011). In 2020 over $3 trillion in such securities were issued, and for the second quarter of 2021 the number was over $1 trillion. SEC. IND. & FIN. MKTS. ASS'N, SIFMA RESEARCH QUARTERLY — 2Q21 9 (July 2021).

191. Langbein, *supra* note 72, at 183.

192. *See* THE FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT 127–55 (2011).

riskiness of some tranches) have nothing whatsoever to do with using trusts as the legal bucket to hold CDO assets. A properly regulated and responsibly run CDO market can dramatically improve financial intermediation and so yield the benefits highlighted in the previous paragraph.

Based on these two very important examples, trusts seem to play a very positive role in financial markets and financial intermediation in particular. As creative lawyers dream up other novel ways to slice, dice, and reconfigure cash flows from various assets old and new, a fully flexible trust may well remain an essential ingredient in their financial recipes. Thus, at the same time that this Article proposes getting rid of the trust as a tool of general application, it recommends the creation of the exact same tool that is limited to public investment vehicles—a tool I dub the "financial trust." The nature of the limitation is important; if it is too vague then inventive lawyers will find ways to deploy financial trusts to some or all of the disfavored uses discussed in Part III.B *supra* and other anti-social ends. The best approach is to define financial trusts in terms of the benefits that they yield, via expanding financial intermediation. To qualify as a financial trust, the managers of the trust (possibly, though not necessarily, the trustees) must establish an investment opportunity and permit all interested investors to participate. The financial trust might permit managers to establish some other screens, such as minimal investment amounts or a limited time window within which to invest. It is hard to see how these minor deviations from the "accept all comers" rule would enable the use of financial trusts for undesirable purposes.

Critically, this new limited flexible category, financial trusts, purposefully excludes business/commercial trusts, i.e., the limitation to financial purposes precludes use for most businesses as most businesses do not contribute materially to financial intermediation and are not open to all comers. This limitation is necessary because it seems difficult if not impossible to define the capacious term "business" in a way that would permit desirable uses of very flexible trusts while preventing their less desirable counterparts. The "business" of what amounts to a self-settled spendthrift trust, e.g., could be said to be in the business of maximizing the investment income of its settlor/beneficiary. To give one more example, drafters could cast the functional equivalent of a dynastic trust as a business to generate maximal benefits for generation after generation of a family. The bottom line is that financial trusts meaningfully limit the use of flexible trusts to entities serving the entire investing public, but there is no clear way to limit business trusts because the term business does not admit of any clear bounds.

I have left the most difficult piece for last: private donative trusts. Such trusts' social value ranges from the extremely valuable (e.g., trusts for those with disabilities who are unable to support themselves) to the socially detrimental examples examined in Part III.B. Thus, the policy challenge here is to provide a relatively restricted version of the trust that permits desirable trusts but bars their use to achieve deleterious ends.

One solution would be to bar donative trusts entirely and force those wishing to provide for those with disabilities to use a guardianship or a conservatorship.[193] Guardianships, however, deprive wards of *all* agency: they cannot even make decisions about medical treatment without their guardians' approval.[194] Guardianships are designed to serve people with mental disabilities so severe (e.g., younger people with learning disabilities; elderly people suffering from dementia) that they are completely unable to manage any important life decisions.[195] This is a draconian remedy unsuited for people with less serious disabilities. Conservatorships, a more limited device that generally deprives the subject of only control over her financial affairs, also seem too heavy-handed for those with less severe disabilities.[196] Disabilities come along a fine-grained continuum. Guardianships and conservatorships are valuable tools for some with the most serious disabilities but are overkill for those able to manage at least some of their own affairs.[197] Personal autonomy has great value to most people, and thus, the law should aim to provide some limited version of trusts to preserve as much self-determination as possible for those with less severe disabilities. I propose three major restrictions on a new donative trust entity, dubbed the "restricted donative trust" (RDT), designed to screen out abusive uses while preserving the utility of the tool for those able to manage some of their own affairs and for garden-variety estate planning. First, settlors of RDTs may not hold any beneficial interest in trusts that they create. From one perspective, this should not be a big deal: isn't a gift

193. These devices were briefly introduced *supra* note 154. The doctrinal summary that follows describes the law of guardianships and conservatorships with a broad brush; there is considerable variation from state to state in the contours of both devices.

194. *See generally* Bella Wong, *Conservatorship vs. Guardianship*, LEGALZOOM (Feb. 1, 2023), https://www.legalzoom.com/articles/conservatorship-vs-guardianship.

195. *Id.*

196. *Id.*

197. A number of developed legal systems apparently do not consider it "draconian" or "overkill" to dispense with anything like the trust and have those wishing to help the disabled use devices like guardianships and conservatorships. "European law has various special purpose institutions that serve as substitutes for the trust in certain well-defined situations. These include, for example, special guardianship institutions to manage assets on behalf of minors or incompetents." Hansmann & Mattei, *supra* note 105, at 442.

to oneself a matter of pure form devoid of any real effect? From the perspective of current trust law, however, the answer to this question is an emphatic "no." Self-settled spendthrift trusts (Part III.B.2) rely entirely on self-grants to achieve their inequitable ends—they formally amount to little more than moving cash from a shirt pocket to a pants pocket. Oligopolistic trusts (Part III.B.1) also rely on self-grants: the parties to such trusts in restraint of trade retain all of the benefits of the shares placed in trust. GRATs (Part III.B.4) illustrate that permitting even partial self-grants opens the door to anti-social purposes, in that case tax evasion.

It isn't difficult to plumb the dangers of self-grants to a trust. In particular, partial self-grants (necessarily including a partial grant to others) allow donors to blur the lines between ownership and control, permit them to manipulate the timing of valuation and other legally significant events, and enable an infinitely flexible and fine "slicing and dicing" of property interests that is a potent means to evade laws of many stripes.

At first blush, some may believe that this restriction prevents perfectly acceptable transactions, such as the ubiquitous estate plan embodied in "O grants Blackacre to O for life, then to A." Note, however, that there is no trust in this grant—and no need for a trust. This is important. Grantors who wish to retain some interest in gifted property remain entirely at liberty to make such gifts; they simply cannot use a RDT or any other trust-like entity to effectuate the gift. The policy rationale for this restriction is clear: self-grants are unnecessary for garden-variety support of people with disabilities and estate planning and are a tool of great potential mischief when deployed to other ends.

The second restriction on the proposed RDT entity is that beneficial interests must be fee simples,[198] life estates, terms of years, or terms conditional on one or more of a small set of contingencies: a birth, a death, a marriage, or a change in disability status. These restrictions impose no burden on settlors using trusts to provide for those with disabilities or engaging in normal estate planning. Support for beneficiaries with disabilities via trusts is not limited to simple life interests; it can terminate if the disability is cured (e.g., a minor coming of age; an amnesiac whose memory returns), and can commence if someone becomes disabled (e.g., suffers from dementia later in life).

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198. Historically and perhaps still doctrinally, fee simple interests exist only for real property. CORNELIUS J. MOYNIHAN, INTRODUCTION TO THE LAW OF REAL PROPERTY 26–30 (2d ed. 1987). My informal use of the term here is broader, encompassing unconditional ownership of personality as well as realty.

The motivation for this second restriction is quite similar to that for the first. Woven into legal regimes like inheritance, tax, and debtor-creditor relations are well-developed rules to deal with common property interests like terms of years, life estates, changes in family status, and simple contingencies regarding disabilities. There is no way, however, for lawmakers to design these bodies of law to deal with the limitless novel and complex beneficial interests that settlors can create within trusts. This enables trust settlors to create aberrant beneficial interests that blur doctrinal legal categories in order to avoid laws of general application (e.g., taxes; creditor protections) in ways that appear inconsistent with the efficiency and fairness policies inherent in those legal rules. Perhaps, the most important targets of this restriction are dynastic trusts. It is this Article's assertion that limiting trust beneficiary interests to a small set of traditional estates makes it impossible to engage in any of the more aggressive strategies to maintain family socioeconomic status for generations without end.[199] Note again, that the reform proposed in this section does not bar donors from making gifts outside the short permitted list; it merely denies them the ability to use any trust-like entity as a container to hold the nonstandard interests. Note also that the Numerus Clausus doctrine severely limits the types of "naked" property interests that donors can create outside of trusts.[200] This limitation, combined with the restrictions imposed by RDTs, goes a long way to undoing the damage wrought by the widespread repeal of the Rule Against Perpetuities, which has paved the way for the return of the undeniably feudal dynastic trust.[201] There is no denying that eliminating the general purpose trust and forcing donors to use the constrictive RDT would fundamentally refashion the law and practice of donative transfers for the wealthiest segment of the population. As emphasized repeatedly in this Article, the net negatives of innovative uses of the current law of donative trusts justifies such a far-reaching change in the law. The RDT may be overkill. It was not designed with the purpose of implementing some ideal minimally necessary set of restrictions; rather, it was crafted as a robust answer to problematic donative trusts. Despite the potential for overkill, I chose this robust approach with the anticipation that inventive lawyers will probe the RDT for loopholes and end-runs. Indeed, despite the prophylactic design of the RDT it seems virtually certain that lawyers will find ways to frustrate its purpose. Lawmakers will need to respond to these assaults on the walls that

199. *See* Kades, *supra* note 60, at 2.
200. Numerus Clausus was explained *supra* notes 73, 84–85 and accompanying text.
201. *See* Kades, *supra* note 60, at 14.

the RDT establishes. In anticipation of such legal jousting, this Article proposes the inclusion of a canon of construction for the restriction on the types of beneficial interests in RDTs:[202] judges and juries should construe the permitted interests narrowly. This means that close calls should be decided against settlors trying to create RDTs that would frustrate its purpose of eliminative socially undesirable use of trusts.

CONCLUSION

Having proposed a calibrated solution to the problem of the overly flexible trust, I conclude with an improbable analogy to a very different tool involving calibers: firearms. Like trusts, guns are a tool used for a wide range of purposes—some very good and some very bad. They are essential to national security and also for local policing—if only because so many domestic malefactors possess them.[203] There are then some positive uses that come with caveats. Although the risks to private citizens of owning guns seems to outweigh their utility as a means of self-defense,[204] they do enable people to defend themselves and provide some sense of security. To give one more example, hunting has its critics but seems to provide significant utility to many folks and in some circumstances may be an unmitigated good, e.g., in thinning areas with overpopulations of deer, or in killing predators that develop a taste for humans or pets. At the other end of the spectrum, the anti-social uses of guns are too obvious to belabor, e.g., as a tool to facilitate murder, rape, armed robbery, and intimidation.

This amalgam of both good and bad uses calls for balanced (calibrated) regulation of firearms, and that is precisely what we observe in U.S. law. The military and the police enjoy virtually unfettered access to firearms of every sort, from handguns and rifles up to machine guns and other more powerful weapons. Although there are sharp disagreements about striking the proper balance for private uses, it is relatively easy for people to obtain firearms that serve valuable functions (handguns for self-defense; rifles for hunting) but virtually impossible to procure machine guns and other heavy weaponry. Additional regulations aim to keep guns out of the hands of known criminals, and bar bringing weapons into courtrooms and other

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202. Note that the first restriction, barring settlors from having *any* interest in an RDT, is such a clear, bright-line rule that it does not require a similar canon of construction.

203. Note that in the gun-scarce United Kingdom, fewer than 10% of police officers carry guns, and most would like to keep it that way. Kevin Helliker, *The Unarmed Cop*, BRUNSWICK (Aug. 11, 2020), https://www.brunswickgroup.com/unarmed-police-gun-violence-i16530?trk=public_post_comment-text.

204. DAVID HEMENWAY, PRIVATE GUNS PUBLIC HEALTH 27, 64, 78 (new ed. 2017).

public places.[205] The overall plan is clear despite heated debate over the details: to simultaneously maximize the benefits of firearm use and minimize antisocial uses.

Despite other patent differences, trusts are much like guns in having a wide spectrum of uses. Parts I and III summarized some of the socially injurious ends to which trusts have been deployed over the last eight-odd centuries. We should not forget, however, the many valuable uses of trusts: providing support for those unable to support themselves, a wide variety of savings and investment activities, from pension funds to collateralized debt obligations to mutual funds.

Unlike gun regulation, current trust law has no systematic legal effort to separate wheat from chaff. At present, anybody may use the shape-shifting common law trust for virtually any purpose. Attempts to rein in undesirable features of trusts are disparate and disorganized, with every domain of law (e.g., tax; inheritance; competition policy; debtor/creditor law) left to craft its own rules to curb abusive trusts. This is like placing no general regulations on possession and use of firearms, and instead enacting piecemeal bans: e.g., "no guns for committing murder," "no guns for committing robbery," "no machine guns for hunting deer," and on and on. This is a woefully inefficient way to minimize the costs imposed by anti-social trusts. Instead, as advocated in the previous section, the law of private trusts needs foundational reform. As currently constituted, trusts are simply too flexible for our own good. We can capture most of the positive uses of trusts and eliminate most of the negative uses by preserving fully flexible trusts for financial innovation but otherwise imposing stringent restrictions on all other private trusts.

205. *See, e.g.*, The National Center for State Courts, *Guns in Court*, 101 JUDICATURE 5 (2017).