Trust as Organizational Law

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The regulation of trust business is now under reform project and you can easily expect that trust is going to be more widely used in Japan. But trust used to be rather unfamiliar legal device in this country so that it is not yet fully understood what are the discriminating characteristics of trust, how and when you should utilize trust, and how the law of trust should be revised in the future. Because trust is sometimes used as alternative scheme for corporation and other legal entities, it is of great use to understand trust as a kind of 'organizational law' and to get a relative view of trust.

As to the concept of 'organizational law', this paper borrows from the paper by Professors Hansmann and Kraakman.[1] Hansmann and Kraakman define 'organizational law' as those rules that have some degree of asset partitioning. Asset partitioning consists of affirmative asset partitioning, which means that business creditors have priority on business asset of manager, and defensive asset partitioning, which means that private creditors of manager have priority on private asset of manager. Hansmann and Kraakman regard asset partitioning as an 'essential role' of organizational law, which cannot be implemented without organizational law or can be implemented only with unrealistically large cost.

From their point of view, an organizational law can be seen as a compound body of legal rules that consists of essential elements and non-essential elements. Each organizational law contains some degree of essential elements as its core but is different from other organizational laws with respect to non-essential elements. One organizational law has a particular set of default rules, and another organizational law has a dif-

ferent set of default rules.[2]

Of course, this view is only one of possible views of organizational law and cannot explain all aspect of organizational law. For example, if asset partitioning was the only essential role of organizational law, a 'bare' organizational law, which provides only essential elements and no nonessential elements, could exist. But undoubtedly you cannot find such organizational law anywhere. This implies that there are some elements other than asset partitioning that are common to every organizational law. Unfortunately, there seems to be no comprehensive list of such elements; no plausible theory to explain them has been developed. However the view of Hansmann and Kraakman is a useful one and you can keep using it for the time being.

Then, how can trust be understood from this viewpoint? First, trust is equipped with the characteristic of organizational law: trust creditors have priority on trust asset over trustee's creditors and beneficiary's creditors. Second, trust is lightweight version of organizational law. On one hand, the law of trust has fewer rules on governance mechanism than the law of corporations. On the other hand, the law of trust provides more reliable scheme for asset partitioning than the law of partnership.

Up to this point, this paper has been analyzing trust from the viewpoint of Hansmann and Kraakman. But two other professors also try to grasp another distinguishing feature of trust. So, for a while, let us turn onto these complementary views of trust.

First, Professor Schwarcz[3] insists that the distinguishing feature of trust be multiple classes of beneficiaries and duty of impartiality as interest-balancing mechanism among them. But this view is flawed. If the party is confronting the problem of multiple principals, it can resolve the problem by using a single class beneficiary --- you can find such solution in case of corporation: corporate share. Also, duty of impartiality is just a default rule and not a mandatory rule so that you can modify it

through contract if you do not want it.

Second, Professor Triantis[4] suggests that the role of organizational law be to set an internal capital market that constrains exploitation of real option by manager. He says that the law of trust has neither advantage nor disadvantage over other organizational laws in this viewpoint but that the trust doctrine is useful in case of charitable organizations. In charitable organizations, fund contributors usually do not have as much control right as in business corporations. Thus they have strong interest in constraining discretion of manager and the trust doctrine provides a useful tool for this purpose: dividing one organization into multiple internal caplital markets.

Triantis's idea is an attractive one but does not seem to be fully plausible. You can implement this purpose through the law of corporations, if only partially. First, you can specify the purpose of the corporation through the article of incorporation and resort to the ultra vires doctrine. By doing this, you can achieve some degree of division of internal capital markets. Second, you can divide the corporation into several pieces and let the same managers administrate them. This implies that what Triantis refers as division of internal capital markets inside one organization is just multiple organizations with common managers.

After checking the two other complementary ideas, you can get back to the view of Hansmann and Kraakman. Understanding trust as lightweight version of organizational law gives you several interesting propositions.

First, trust can be used as an emergency device. Suppose a new style of business comes on the scene. If you use trust to run this business, you need to make some contractual supplement to fit the trust into this business purpose. At the same time, you can use other organizational law and put up with the inconvenience caused by non-essential elements of that organizational law. You choose to use trust when the

contracting cost is less than the cost of such inconvenience.

Second, trust can be a base for various new organizational laws. Although trust can be used as an emergency device, it is desirable to evolve the additional contractual arrangement into a new organizational law if such use persists. This will reduce transaction costs and contribute to social welfare. You can see good examples of this phenomenon in the variety of the use of commercial trust in Japan.

Third, you can get some insights about lawmaking policy. First, if you observe use of trust in practice, it can be a sign of inefficiency of existing organizational laws. In this case, it may be socially desirable to enact a new organizational law. Second, the law of trust should contain those rules that are suitable for every possible business purpose, but it should not contain excessive rules that prevent trust from being used as an emergency device.

（1） Henry Hansmann & Reinier Kraakman, The Essential Role of Organizational Law, 110 Yale L. J. 387 (2000).

（2） To see what set of default rules is appropriate for a particular business purpose, you can get a brilliant idea from professor Hansmann's another work: Henry Hansmann, The Ownership of Enterprise (1996).

（3） Steven L. Schwarcz, Commercial Trusts as Business Organizations: Unraveling the Mystery, 58 Bus. Law. 559, 575-80, 585 (2003).

（4） George G. Triantis, Organizations as Internal Capital Markets: The Legal Boundaries of Firms, Collateral, and Trusts in Commercial and Charitable Enterprises, 117 Harv. L. Rev. 1102 (2004).