BUSINESS TRUSTS AND BLUE SKY LAWS

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Considerable discussion is being aroused by the increasing resort to the declaration of trust as the means of creating another vehicle for the carrying on of business. These vehicles, which for the purpose of this article are loosely referred to as organizations, have been variously called common law corporations, common law companies, voluntary associations by declaration of trust, Massachusetts trusts, trusts embarked in trade, trust estates as business companies, and business trusts. Authorities generally credit their origin to the Massachusetts real estate trust devised to meet a statute of that state prohibiting corporations from holding title to real estate. Designed originally to meet an obvious difficulty the last few years have seen the trust instrument appealed to throughout the country and trusts purported to be declared for the carrying on of every conceivable kind of business or undertaking. This development has been so extensive that the modern business trust has by some been heralded as the successor of the corporation.

The greatest growth has been in the launching of new enterprises, established business preferring as yet to retain the corporate organization. And while in many instances its use has been in good faith, in recent years the business trust as an organization for the carrying on of business has become more and

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1Sears, Trust Estates as Business Companies; Dunn, Trusts for Business Purposes; Conyngton, Corporate Organization & Finance; Thompson, Business Trusts as Substitutes for Business Corporations; Corporations and Express Trusts as Business Organizations by H. L. Wilgus, 13 Mich. L. Rev. 70, 205; The Government and the Corporation, by F. L. Stetson, 110 Atlantic Monthly 27; The Mysterious Massachusetts Trust, by William W. Cook, 9 Am. Bar Ass'n Jour. 763.

2The Passing of the Corporation in Business, by R. J. Powell, 2 MINNESOTA LAW REVIEW 401.
more attractive to promoters and organizers of new enterprises who are constantly on the lookout for a new sugar-coated pill to assist in foisting their securities on the unwary public. This organization has, therefore, become a vital problem for the various bodies administering blue sky laws designed primarily to regulate the offer and sale of speculative securities. It is the purpose of this article to discuss the application of such laws to business trusts and the problems which are raised.

Do Blue Sky Laws Cover Business Trusts?

The first question is whether such organizations are subject to blue sky regulation. When the modern business trust was new there were no such regulatory laws and no thought was given to this question. Since such laws have come into existence various theories have been devised to take them out of the scope of the statutes, many of these being propounded by the promoter who is essentially a salesman and not necessarily learned in the law. The claim that exemption from blue sky laws was to be enjoyed has, it is believed, been one of the causes of so many such organizations being created, especially in cases where the proposition aside from the form of organization lacked sufficient merit to obtain the necessary license. It has been stated that they are new creations based upon forgotten constitutional rights and individual liberties; that they are organizations under the federal courts; that they are organized under the federal common law; that their legality and right to exist was due to the fact that "the constitution holds certain rights as self-evident basic rights, and provides that neither Congress nor state legislatures shall have power to interfere with them;" and that they are for all times free from legislative enactments, including blue sky laws. Freedom from all the statutory enactments applicable to corporations has been a substantial selling point in the hands of the promoters and others engaged in the business of organizing business trusts. In some cases it has been contended that although a business trust is an organization which is subject to regulation by blue sky laws, the particular law in question did not by its language cover the specific case. Several cases have been decided on these points.

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9 Most of the organizations involved in the recent cleanup of oil stock promoters in the south resulting in the conviction of the many times famous Dr. Cook, purported to be trusts. Of the main organization Dr. Cook was sole trustee.

14 From a typical circular issued by a printer who sells blanks for the formation of business trusts.
The leading case is *People v. Clum*, in which it was held that the certificates of preferred stock of the Business Men's Protective Association, an association organized "under the common law having a declaration of trust in favor of the association" was stock within the meaning of the Michigan securities law, and that the sale thereof was prohibited except in compliance with the statute.

An Iowa case holds that the "member's certificate of interest" in the Texlouana Producing and Refining Company, a common law company formed by agreement and declaration of trust, is stock within the meaning of the Iowa securities law, against the contention that the certificates were merely "certificates of a beneficiary share in certain trust property" and that the word "stock" can apply only to corporate stock. The court said that: "Its capital is a share capital evidenced by certificates which may pass from hand to hand," that the certificates give the holders "no legal right to the property of the trust" and that the word stock "in common parlance is often used in a broader and more general sense of shares in voluntary associations and other enterprises in which many contribute shares for the promotion of some common purpose."

In Idaho, it was held that the Montana Syndicate, a common law trust organized under the laws of Montana, was an "association" within the meaning of the Idaho securities law.

In an Illinois case, the shares of capital of the American Manufacturing Company, an unincorporated association holding itself out as organized under the common law in force in Illinois, were held to be securities within the Illinois securities law. The statute referred to securities issued by corporations, associations, trusts, etc., organized under the "laws of the state." It was contended that the law applied only to securities issued by corporations, associations, trusts, etc., organized under the statute law of Illinois and not to those organized under the common law. The court held that the language applied to all those organized under the laws of Illinois whether statutory or common. It was also contended that the American Manufacturing Company was not organized under any of the laws of Illinois, either statutory or common, but was based upon a written instrument or contract between the parties, which contract created a trust

5* (1921) 213 Mich. 651, 182 N.W. 136. This case also holds that a sale by a trustee of a business trust is not a sale by one in a trust capacity created by law and entitled to exemption as such.


7*State v. Coggrove, (1922) 36 Idaho 278, 210 Pac. 393.

8*Kinross v. Cooper, (1922) 224 Ill. App. 111.
and authorized the issuance of securities in question, and that to hold it to be within the regulations of the Illinois securities law would impair the obligations of a contract and violate the federal constitution. This contention was not recognized, the court holding that the police power of the state as represented by the Illinois statute in question was paramount.

In Missouri, the court allowed rescission of a contract for the purchase of shares in the Missouri Oil & Gas Company, a common law company operating under a declaration of trust, one of the reasons being that the contract of purchase was in violation of the Missouri securities law, no license ever having been issued for the sale of the shares in question.

In *Home Lumber Company v. Hopkins*, the Home Lumber Company, which purported to be a common law company formed by declaration of trust, itself brought mandamus to compel the State Charter Board to entertain its application for license to sell securities in Kansas, the board having theretofore refused the application for reasons hereinafter considered. The supreme court held on the facts at hand that the Home Lumber Company was a pure trust, that the board's position was not tenable and that mandamus should issue, a ruling which was necessarily based upon a finding that the organization was within the jurisdiction of the Kansas securities law and that the board must, therefore, accept and consider its application.

A peculiar result was reached in Oregon in the case of *Superior Oil & Refining Syndicate, Ltd. v. Handley*. The plaintiff was organized by declaration of trust under the laws of the state of Texas to manufacture brick and refine crude petroleum, the declaration providing for the sale and issuance of certificates of beneficial interests, the proceeds from such sale to be held in trust and managed for the benefit of the certificate holders. The Oregon securities law expressly exempted "state and national bank and trust company stock," the Oregon general statutes providing that trust business shall include any private trust and that no foreign partnership, firm, joint stock company, or association should act in a trust capacity in Oregon without complying with the provisions of the Oregon statutes with reference to trust companies. On application for mandamus to compel the issuance of a license for the sale of stock the writ was denied, the court holding that the applicant organization was

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9 *Schmidt v. Stortz*, (Mo. 1922) 236 S.W. 694.
11 *(1921)* 99 Ore. 146, 195 Pac. 159.
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within the statutory definition of a trust company and therefore expressly exempt under the securities law. The court did not intimate that such organizations were not amenable to the securities law but sustained the position of the enforcing officer only because of an express exemption.

In *Ex Parte Girard*, a writ of habeas corpus for the release of a trustee who had sold securities of his trust estate without license under the securities law of California was refused. The California law expressly provided that the word “trusts” as used in the law shall include all voluntary trusts, but the decision is in point to show that such organizations are subject to regulation by a blue sky act.

In Kentucky, the court held that the Shareholders' Syndicate, purporting to be a common law trust, and its units of interest, were within the securities law.

The case of *State ex rel. Great American Home Savings Institution v. Lee, Supervisor of Building and Loan Associations*, is frequently cited as holding that business trusts are valid and not amenable to blue sky laws. In this case the Great American Home and Savings Institution formed as "an unincorporated association of individuals" brought mandamus to compel the issuance of a certificate authorizing it to do a building and loan business on a plan set out in its declaration of trust, which trust agreement constituted the plaintiff, in the opinion of the court, "what is familiarly known as a common law trust." The Missouri statutes expressly provided that unincorporated associations could do a building and loan business. It was contended that the company was within the blue sky law and that it had not complied therewith. The court held with reference to the provisions for compliance with the building and loan statutes that "this requirement is exclusive" and that the company "is not required to obtain permission to do business from the state bank commissioner under" the blue sky law. The result in nowise holds that the organization is a pure trust or that it could not be made subject to blue sky regulation. Neither does it show that business trusts have any inherent right to do business in any place, as the statute in question expressly authorized the doing of this business by unincorporated associations.

The result in these cases has usually been reached without determining whether the organization in question was a pure

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12(1921) 186 Cal. 718, 200 Pac. 593.
13King v. Commonwealth, (1922) 197 Ky. 128, 246 S.W. 162.
14(1921) 288 Mo. 679, 233 S.W. 20.
trust or not, the court considering it sufficient to say that it was an "association," or that it clearly was within the broad language which includes person, company, co-partnership and association, and in others that its certificates were securities within the meaning of the statutes in question. The cases, therefore, cannot all be cited as directly holding that the organizations considered were pure trusts, or that pure trusts are amenable to blue sky laws. However, had the courts been of the opinion that the question of amenability turned on whether or not the organization was a pure trust, the decisions doubtless would have covered this point. The reasoning of the cases is sufficient to include all organizations commonly referred to as business trusts and to indicate that the courts regard an express trust as amenable to the reasonable exercise of the police power represented by blue sky laws. These laws have been held constitutional, and their application to business trusts does not unreasonably interfere with any constitutional rights. Whether such organizations are based upon the common law, the inalienable right to contract, or what not, they have no particular charm which removes them from the scope of the broad general field of regulation embodied in such laws. As stated by the court in King v. Commonwealth:

"The contention that the act so construed abridges the right to own property and freely contract with reference thereto in contravention to rights declared to be inalienable and guaranteed to all persons by the state and federal constitutions, is in our judgment wholly lacking in merit."

The statutes construed in most of the above cases have the usual broad language of blue sky laws, which language was considered sufficient to cover the organization in question, the California case being the only one where the language expressly refers to trusts. The scope of the laws of other states, including Minnesota, has not been determined, but it is reasonable to believe that these cases will be followed and that any statute, such as the one in Minnesota, which requires license for "every person, firm, co-partnership, corporation, company, or association" offering or selling "any stocks, bonds, investment contracts, or other securities issued by him, them, or it" will be held to cover all the organizations commonly referred to as business trusts.

As stated most of the decisions regard these organizations for the purposes of blue sky laws as associations. The definitions

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16(1922) 197 Ky. 128, 246 S.W. 162.

17Minn., Laws 1917 chap. 429, as amended.
of the word "association" usually convey some idea of agree-
ment, co-operation, joining together, or mutuality among the
members. If these organizations are what they purport to be,
pure trusts, it is difficult to see how any of the earmarks of an
association are present. The beneficiaries are not associated to-
gether in any manner, there is clearly no association among the
trustees and the beneficiaries, and the trustees are only loosely
associated as co-trustee.  

The presence of any elements con-
stituting an association of any of the interested parties probably
precludes a pure trust. A business trust, if a valid pure trust,
presents nothing more than natural persons exercising as trus-
tees the powers conferred by the declaration, among which is
the power to offer and sell certificates representing the beneficial
interests in the estate. There is no super-added entity or associa-
tion as principal over and above the trustees. The trustees as
individuals, working under a trade name, are the principals and
when certificates representing beneficial interests are sold by
them, they are, so far as blue sky laws are concerned, "persons"
offering and selling "stock . . . issued by them." That a trust
estate is after all the individuality of the trustees is strongly ad-
vocated by sponsors of business trusts as giving them the right to
do business in any state subject only to such regulations as are
imposed on the citizens of that state, as freeing the organization
from certain kinds of taxation, and as the basis for many of the
supposed advantages. If this view of a pure trust is correct,
it is clear that the general wording of the usual blue sky law is
sufficiently broad. It disposes of the contention advanced in
Kinross v. Cooper, that a business trust was an association or-
ganized by contract and not by virtue of any law, statutory or
common, and was therefore not within the provisions of statute
covering associations organized under the laws of the state, which
position is adopted by a recent text book. This view is sup-
ported by the following excerpt from the minority opinion in
State v. Cosgrove, as follows:

"The unit stockholders of a pure trust have no mutual rights
and obligations. . . . The corporation is an artificial being, a

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18 See Crocker v. Malley, (1919) 249 U.S. 223, 63 L. Ed. 573, 39
S.C.R. 270.
19 Business trusts probably must comply with the trade-name statutes.
Filing declaration not sufficient. See Sears, op. cit., p. 375 and 405; Wilgus,
13 Mich. L. Rev. 209; Minn., G. S. 1913, chap. 56B.
20 (1922) 224 Ill. App. 111.
21 Dunn, Trusts for Business Purposes, chap. 2.
22 (1922) 36 Idaho 278, 210 Pac. 393.
trust is no being at all. A trust is an estate, the equitable title to which is held by individuals, who bear no contractual relation between themselves. The Montana Syndicate is but a name representing no being, real or artificial, and possessing no powers or privileges whatsoever, corporate or otherwise."

Had the majority been of the same opinion the organization being considered would have been held to be outside the Idaho securities law which includes “every corporation, every co-partnership, and every association” and does not use the word “persons.”

These cases also seem to dispose of the contentions that certificates of beneficial interest represent an undivided portion of the corpus of the trust, and are not securities, or that the words of the statutes refer only to corporate stock. The courts have construed the words “stocks,” “bonds,” and “securities” very broadly to cover anything which is representative of a share in an organization having a share capital, without determining just what the security was.

Assuming, as the cases indicate, that the various organizations referred to as business trusts are within the laws in question, regardless of whether they are pure trusts or not, and that their certificates of beneficial interests are securities the sale of which is regulated by such laws, how should they be considered on formal application for license to sell such securities? Applications for license to sell stock usually require some showing as to the nature of the issuing organization. When the applicant is a corporation it is essential to determine whether the corporation is regularly and legally organized and is in fact what it purports to be and will represent itself to be, and whether what it desires


24Because of the adverse decisions rendered some business trusts issue a certificate which recites that it is evidence of the holder’s interest in an undivided portion of the real estate and other property belonging to the trust, an apparent attempt to avoid the elements of a share capital. It seems obvious that such attempts remove the first essential of a pure trust, namely a corpus the legal title to which is exclusively in the trustees. However, assuming that such could be done and that such a certificate is evidence of ownership of certain property, an additional provision to the effect that the profits of the business shall be divided among the certificate holders constitutes the certificate, at least so far as Minnesota is concerned, an “investment contract” and therefore a security within the Minnesota law. Participation in profits must be present to make the certificate salable. For cases discussing the words “investment contracts” in Minnesota, see State v. Gopher Tire & Rubber Co., (1920) 146 Minn. 52, 177 N.W. 937; State v. Evans, (1922) 154 Minn. 95, 191 N.W. 425; State v. Ogden, (1923) 154 Minn. 425, 191 N.W. 916.

to sell, namely stock in a corporation, is in fact such. Applications from the organizations under discussion will represent that the applicant is a common law company organized by declaration of trust, or some other similar expression, which description together with the declaration will disclose that applicant purports to be a trust estate and to enjoy its rights and privileges as a pure trust by virtue of the law of trusts. The use of the word "trust" as descriptive of the organization, or saying that it is formed by "declaration of trust" precludes any other conclusion. On such applications the questions are similar to those raised by applications from corporations. Is the applicant in fact a trust? Is it what it represents itself to be? Are its securities, whether called certificates of beneficial interest, stock, shares, or units, what they purport to be, namely, evidence of ownership of a beneficial interest in a pure trust?

Mere statements that the organization is a trust is not sufficient but consideration must be given to the entire declaration in the light of the law applicable. On analysis all of the organizations purporting to be business trusts present nothing more than the old recognized trust instrument which has been added to and changed in an attempt to create a vehicle adapted to the desired purpose. They must still be trusts in fact or they fail to be what they purport to be, a test to be made by the well established law of trusts. They can enjoy the advantages claimed, such as no liability on beneficiaries, perpetual succession, etc., only if they are in fact pure trusts. Recognition of this rather than approaching them as new creations clarifies the problem.

Considered in this manner many of these organizations will fail as pure trusts. As noted, the modern growth of the use of the declaration of trust has seen an amplifying and changing of the instrument to meet the particular purpose for which the organization is to be used. In addition an intention has been shown to avoid the many burdens attaching to the corporate organization but on the other hand to retain all the advantages, this being especially true in those in which an appeal must be made to the public for finances through the sale of beneficial interests. The promoter has sold his creation to the public by reciting all the sins of the corporation and representing that his organization was free from these but at the same time had all the corporate advantages. For example, giving the beneficiaries power to elect trustees, to amend the trust instrument, to reject the beneficiary interest in the trust, etc. In other words, as in the few cases where the use of the trust instrument has been made in such a way as to avoid the burdens attaching to the corporate organization, the instrument is still a trust.

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move trustees,\textsuperscript{28} to terminate the trust,\textsuperscript{29} to hold annual meetings and take such action as they deem best,\textsuperscript{30} or in fact giving the beneficiaries any control whatsoever over the trustees or the estate so that the beneficiaries are the masters and the principals rather than the trustees being in absolute control,\textsuperscript{31} have been held to preclude the creation of a pure trust. Other features have been held bad such as providing for an absolute suspension of the power of alienation for a longer period than is permissible.\textsuperscript{32} These are matters to be determined by the general laws of trusts of the state by which the organization is to be tested, as is true of all the provisions of the instrument. It is not the purpose of this article to consider such questions, reference being made to some cases, however, to show how the courts have approached such organizations and as indicating that the presence of any provision in a declaration which does violence to the trust laws applicable defeats the creation of a pure trust. Business trusts must stand the test of the strict laws of trusts.

Applications from such organizations for license to sell securities open the entire field of trust law for consideration. If for any reason the attempted organization fails as a pure trust, the applicant is not what it purports to be or what it represents and will represent itself to be, but is some sort of loose unincorporated association, joint enterprise or profit sharing scheme, whose validity and right to exist and whose privileges and obligations, as well as those of all interested parties, are determined by an entirely different branch of the law. Holding itself out to be one kind of an organization when in fact it is an entirely different organization, is a misrepresentation of a substantial fact, is misleading and deceptive to the purchaser of securities and will result in fraud being committed. The purchaser may, because of the representation as to this fact, believe that he is securing lim-

\textsuperscript{31}See citations under note 1. Also, Partnership Liability under the Business Trust, by N. B. Judah, 17 Ill. Law Rev. 77; Limited Liability in Business Trusts, by Robert S. Stevens, 7 Cornell Quart. 116; Sears, op. cit. pp. 144 and 369; A Survey of Business Trusts by Frederick A. Thulin, 16 Ill.L.Rev. 370.
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ited liability and the other advantages supposed to attach to a certificate of beneficial interest in a pure trust. And while representation as to the legal effect of the organization may be a representation of law only and not the basis for the commission of fraud, the usual case will involve a representation as to substantial facts. Again, failing as a pure trust, its securities, whether called certificates of beneficial interest in X, an association formed by declaration of trust under the common law, certificates of beneficial interest in a trust estate, stock, participating certificates, or units, are not in fact certificates evidencing ownership of the interest held by the beneficiary of a pure trust, but are in fact certificates evidencing some sort of membership or participation in some sort of unincorporated association, joint adventure or profit sharing scheme, to which are attached substantially different privileges and obligations. Representing a security to be one thing and selling it as such when it is an entirely different security is a misrepresentation of a substantial fact on which the purchaser relies and constitutes fraud. Applications from so-called business trusts which fail as such for any reason must be denied under any law designed to prevent fraud in the sale of securities. And, it is submitted, a blue sky body has the power and should refuse to entertain an application from an alleged trust estate which is illegal and is not what it purports to be.

Do Business Trusts Violate the Corporation Laws?

One of the first attacks made on business trusts was that they exercised corporate powers and enjoyed corporate privileges without complying with the corporation statutes and in violation thereof, that they looked and acted like corporations, that they were therefore illegal and not entitled to recognition, and that they were subject to dissolution proceedings. It is doubtless true that a great many organizations purporting to be trusts have been created by a desire to escape the many burdens attaching to corporations and to find a vehicle having most of the advantages of a corporation. This desire has, in many instances, resulted in a declaration so trimmed up and enlarged that, although talking in the language of a trust, it has contained most of the

33 Schmidt v. Stortz, (Mo. 1922) 236 S.W. 694.
34 If representation is as to the legal effect of the organization by virtue of the law of some other state, there is then a representation of a fact.
features usually associated with corporations, such as a fixed capital, negotiable certificates of stock, officers, boards of directors, executive committees, and annual meetings, supplemented by a claim to limited liability, perpetual succession, etc., and the organization created thereby appeared to look and act like a corporation. That these organizations are in violation of the corporation statutes has been held by the attorney general of Ohio, and of Minnesota. If this is a correct position and they are for this reason invalid and illegal and cannot be created, it is obvious that any body administering a blue sky law could refuse to accept their applications, and, if accepted, would have a duty to deny.

An analysis of the usual business trust shows that the instrument of creation is in the form and language of a declaration or deed of trust, that the only intention disclosed is to create a trust, there being no evidence of an intention to create a corporation, that no attempt is made to comply with the corporation statutes, that there is no overt act in compliance with such statutes, that there is no holding out as a corporation, and that no intention or attempt is displayed to exercise certain powers or privileges as a corporation. It may be true that, if the organization is a pure trust, perpetual succession will be enjoyed in that the trust survives the death of a trustee or a beneficiary, and also that the beneficiaries will have limited liability, in fact no liability. These, however, are advantages attaching to the trust because of the trust laws and not because of any attempt to create a corporation or to acquire corporate powers in violation of the corporation statutes. The general corporation laws are permissive only. They do not provide that certain privileges can be enjoyed only by corporations. Granted that a corporation has perpetual succession, limited liability, etc., by virtue of the general corporation statutes, it does not follow that any other organization securing these privileges by contract, declaration of trust, or any other means, is doing so in violation of the corporation laws and entitled to be dealt with accordingly. Nor are capital, certificates of stock, officers, annual meetings, etc., things to be enjoyed only by corporations and prohibited to all others. Applications from business trusts cannot properly be denied on this ground.

86Sears, op. cit. 343.
87Opinion by Montreville J. Brown, Assistant Attorney General, dated April 30, 1919. See also opinion on same subject dated June 20, 1921.
88See cases cited in note 35.
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ARE BUSINESS TRUSTS CORPORATIONS UNDER THE CONSTITUTION?

Many state constitutions,9 contain provisions of which the following is typical:

"The term 'corporation' as used in this article, shall be construed to include all associations and joint stock companies having any of the powers and privileges (or corporations)40 not possessed by individuals or partnerships, . . . "41

Based on this provision some courts have held that business trusts purporting to have limited liability, perpetual succession, right to sue and be sued in the adopted name, etc., were corporations.

In *Home Lumber Co. v. Hopkins,*42 the Kansas court first decided that the Home Lumber Company, which was formed by declaration of trust, was a pure trust, and that it was exercising and enjoying powers and privileges not possessed by individuals and partnerships, that it was a corporation within the constitutional provision, and that it therefore could not be mandamus-force the state charter board to consider its application for license under the blue sky law until it had complied with the corporation laws. On motion for modification it appeared that the company desired to sell its own securities only and not to engage generally in the business of selling securities, whereupon the court issued the writ, being of the opinion that the sale of its securities alone did not constitute an engaging in business within the meaning of the foreign corporation act and did not require compliance with such laws.43

The Kansas court has since applied this decision,44 holding that service by publication, as provided by the corporation laws, was good against the United States Mexico Oil Company, a "Massachusetts trust," on the ground that it was within the

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10Words in parenthesis appear in some constitutions, including Idaho.
11Minnesota constitution, article 10, section 1.
12(1920) 107 Kans. 153, 161, 190 Pac. 601. See Kansas constitution, article 12, section 6.


14Harris v. United States Mexico Oil Co., (1922) 110 Kans. 532, 204 Pac. 754.
constitutional definition of a corporation and subject to the corporation statutes. A like result was reached in Washington, where the court sustained the secretary of state in refusing to consider the application of the Securities Sales Syndicate, which purported to be a "common law business trust," on the ground that it was a corporation by virtue of the constitutional provision, and was "prohibited from doing business within this state," and had "no legal status in this state." Another line of decisions hold that business trusts are not, because of the definition in question, to be regarded as corporations for all purposes.

In *State v. Cosgrove,* the court says in construing the constitutional definition in question, which is section 16, article 11 of the Idaho constitution:

"It is clear from the very terms of Section 16 that the word 'corporation' was intended to be there defined only as used in Article 11. The section clearly recognizes the existence of corporations in the usual and ordinary sense, as well as of associations and joint stock companies, but for the particular purposes of Article 11, it modifies and enlarges the scope of the term. It is not authority, however, for the altogether antithetical proposition that the term 'corporation' when not used 'in this article' but in a quasi penal statute enacted long before the adoption of the constitution, also includes all associations having or exercising any of the powers or privileges of corporations. . . . A corporation cannot be formed by private agreement between individuals nor can the state force its bounty upon private persons by incorporating them without their consent and against their will."

In *State ex rel. Great American Home Savings Institution v. Lee,* the Supreme court of Missouri says on this point:

"It is obvious that the article of the constitution and statute referred to do not by legislative fiat convert joint stock companies or voluntary associations into corporations or require their incorporation before doing business."

The Kansas theory finds that the usual business trust is an "association," that it enjoys "powers and privileges not possessed by individuals and partnerships," that it is a corporation and has no standing whatsoever until it complies with the corporation laws, that the constitutional provision is a determination

45*State ex rel. Range v. Hinkle,* (Wash. 1923) 219 Pac. 41.
46*Article 12, section 5.*
47See also inference in *Wagner v. Kelso,* (1923) 195 Ia. 959, 193 N.W. 1, that same result might be reached in Iowa.
48The leading case is *Spottwood v. Morris,* (1906) 12 Idaho 360, 85 Pac. 1094.
49(1922) 36 Idaho 278, 210 Pac. 393.
50(1921) 288 Mo. 679, 233 S.W. 20.
of what organizations are to be deemed corporations whenever
the word is used, and either abolishes all associations or joint
stock companies having any of the powers in question or auto-
matically converts them into corporations. It in effect says that
the corporation statutes are exclusive and restrictive and that
any organization enjoying certain privileges must incorporate.
The words "in this article" appearing in the constitutional defi-

The Idaho theory, it is submitted, is the more logical and
gives full force and effect to the words "in this article" by stating
that the provision in question is not a definition of corporations
for all times but only a convenient classification of all such
organizations for the purpose of the article of the constitution in
which it appears.

The Kansas cases are not satisfactory. In one place it is
stated that "to meet requirements of our law the company must
bring itself within the rules applicable to corporations and con-
form to the regulations imposed by statute on corporations." In
another place that "many statutory provisions have been en-
acted for the organization and regulation of corporations which
are wholly inconsistent with the organization and plan of the
plaintiff company, and with which it will manifestly be unable to
conform." In other words it must conform to laws with which
it cannot conform. Again in speaking of the constitutional pro-
vision, "the definition so adopted is not necessarily to be applied
to the word 'corporation' wherever it is used in the statute," a
leaning to the Idaho theory, and yet when used in the general
corporation statutes they give to it the broadest meaning of the
constitutional provision.\(^5\)

The two theories above discussed are in conflict and raise
an uncertainty as regards business trusts. In some states they
are corporations and in some they are not. In others the matter
is in doubt. As to these latter states the trustees of a business
trust who desire to enter a particular state to carry on business
or to sell stock may find that their organization is a corpora-
tion and has no standing whatsoever. On applications for license

\(^{54}\)The Kansas cases attempt to distinguish result reached from that in
Idaho on ground that Idaho definition includes the words "of corporations"
and is therefore limited to those organizations enjoying these rights by stat-
utory enactment, but that the Kansas constitution by leaving these words
out showed an intention to include all organizations regardless of how rights
were secured. The reasoning of the Idaho cases however does not turn on
the inclusion of these words, and the Washington case cited in note 45
reaches the Kansas result on a constitutional provision which includes the
words in question.
to sell securities the blue sky board should consider the applicant to be what it is by the laws of their state regardless of what it may be by the laws of the state of creation. If by this test it is a corporation by virtue of the constitution and as such has not complied with the corporation laws, it has no legal standing and its application should not be entertained. Otherwise an organization which violates the laws of a particular state would nevertheless be given recognition and standing by the blue sky board and permitted to sell its securities in that state. In this respect the final result in the case of Home Lumber Company v. Hopkins, seems not correct, a result which permits an organization which is deemed a corporation but which has not complied with any corporation laws, either of Kansas or any other state, to have full standing before its charter board, and to force that body to recognize its application for license to sell securities. The distinction between engaging in the general business of selling securities and selling its own securities is not sound and does not justify recognizing an organization which is found to exist in violation of law. Once the position is taken that a business trust is a corporation which has not complied with the corporation laws, but exists, if at all, in violation thereof, the matter should be carried to its logical conclusion and the organization given no standing in court, as was done in State ex rel. Range v. Hinkle.

On the contrary, if the applying company purports to be a business trust formed, for example, under the laws of Washington, and which by the case cited would be deemed to be a corporation and in violation of the corporation laws of that state, and application is made in a state where by decisions it would not be a corporation, such as Idaho, it is submitted that the same result should follow, namely, refusal to entertain the application and give the organization any standing. Otherwise the state considering the application would be recognizing the organization in a manner in which the state of creation would not recognize it and would treat it as something which it was not by the laws of such state of creation.

There have been no decisions in Minnesota directly on this point. If by virtue of the Minnesota constitution these organizations are held to be corporations for all purposes, then the result reached in the attorney general's opinion is correct, but

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52 See Harris v. United States Mexico Oil Company, (1922) 110 Kans. 532, 204 Pac. 754.
53 (1920) 107 Kans. 153, 190 Pac. 601.
54 (Wash. 1923) 219 Pac. 41.
BUSINESS TRUSTS AND BLUE SKY LAWS

for a different reason. In such event business trusts regardless of where formed would have no standing in Minnesota and could not rightly be licensed to sell their own securities or to deal generally in securities. In this connection it is again suggested that business trusts which are what they purport to be are in no sense "associations" or "companies" and do not come within the classes covered by the constitutional definitions, even for the purposes of the definitions as limited by the Idaho cases.

STATUTORY ENACTMENTS AFFECTING BUSINESS TRUSTS

Consideration must be given to statutes, if any, regulating the formation of trusts. Broad statements are frequently made to the effect "that a trust may be created for all purposes for which the individual may use property or property rights." Many states, however, have passed statutes purporting to define and limit the purposes for which trusts may be declared. When a particular declaration of trust comes up for consideration its purposes and the powers of the trustees thereunder must be considered in the light of any such statutes in effect in the state by the laws of which the validity of the trust is to be determined. If the trust violates any such statute, the attempted formation fails and the trust does not come into being as such, its certificates represent something substantially different from what they purport to represent, and its application cannot be entertained or granted without giving recognition to an invalid organization. In Minnesota where the statutes have abolished all uses and trusts except those formed for certain specified purposes, it is submitted that the attempted formation of a business trust to explore for oil, to operate a mine, to exploit a patent, to conduct a chain of grocery stores, and, in fact, for the purpose of carrying on any business as distinct from a trust for investment purposes only, fails and the organization has no standing.

55This opinion, it is interesting to note, is based upon the identical organization which by Harris v. United States Mexico Oil Company, (1922) 110 Kans. 532, 204 Pac. 754, was held to be a corporation and in violation of the corporation laws of Kansas.
56See Thompson, Business Trusts as Substitutes for Business Corporations.
57Dunn, Trusts for Business Purposes 4.
58See Bogart, Trusts 160.
59In Bryant v. Shaw, (1920) 190 App. Div. 578, 184 N.Y.S. 315, 911, it is held that the purported trust under consideration was not within the purposes for which an express trust could be formed in New York and that interested parties were not beneficiaries holding an equitable title but held legal title as tenants in common.
60Minn., G.S. 1913, chap. 60.
61In re application of The Investment Trust of St. Paul, the declaration of trust, which was executed in Minnesota and where the principal
PRACTICAL QUESTIONS RAISED BY BUSINESS TRUSTS

Business trusts which are free from all legal objections and are in fact what they purport to be, pure trusteeships, present a practical question in the administration of securities law, for which purpose they are necessarily considered largely from the point of view of the purchasers of securities. Such administrative bodies usually look with disfavor, and rightly so, upon corporations so organized as to place exclusive control in the hands of the organizers or in a class of stock for which little or nothing of value was paid, especially where the organization is new and those who attempt to retain control have not demonstrated that they are entitled to it. Such features have come to be considered earmarks of a promotion in which the organizers hope to profit from the promotion rather than from the success of the enterprise, as opening the door for manipulation, as not letting the purchaser of stock in on a reasonably fair basis, and as not furnishing the means whereby he can follow his investment to his protection. The controlling effect over officers of the voting right, even though not exercised, is an element usually deemed essential to the usual speculative security. What then of a pure trust in which stockholders can have no voting control whatsoever and can protect themselves only by resort to the slow and expensive processes of a court of equity? Are the administrative bodies on consideration of such applications to waive their general theory applied to corporations and discriminate against them? Are they to permit an organization in which the trustees are usually self appointed and may have invested nothing in the enterprise but who are nevertheless the sole managers, finance itself by general sales of securities to the public the purchasers of which securities must thereafter

place of business was located, recited that the trust was formed for the purpose of establishing a trust fund by the sale of beneficial interests and to invest and reinvest same for the proportionate benefit of the beneficiaries. Application was made to the Minnesota commission for a dealer's license under the Minnesota statute, which statute defined a dealer as "Every person, firm, co-partnership, company, corporation, or association ... which shall ... sell or offer for sale any of the securities issued by an investment company ... or who shall ... profess to engage in the business of selling or offering for sale such securities." Application was denied on the ground that the recited powers of the declaration did not cover the transaction of business as a dealer as defined by the statute and also that even though amended to include such powers same were beyond the powers and purposes for which an express trust could be formed as defined by the Minnesota statutes.

See also opinion of attorney general dated June 20, 1921, and cited in note 37.
sit back and see their business managed by those who may suffer no loss upon failure and whose position can be taken from them only by appeal to the equity court and then only by showing mismanagement to the detriment of the trust? Mere lack of good business judgment or failure to make profits, or any other reason which might result in changing corporate officers, will not entitle the stockholder to relief.

Again what of the many advantages and protections attaching to corporate stock such as inspection of books, cumulative voting, right to purchase pro rata share of increases of stock, right of corporation to increase its capital stock by vote of stockholders, right to force declaration of dividends under certain conditions, restrictions against declaration of dividends which impair capital, right to force complete sale of assets and discontinuance of business, and many other rights which will occur to anyone familiar with corporation laws? These are elements which a body administering a blue sky law recognizes as attaching to the corporate security being considered. Are they all to be waived and regarded as unessential when considering a pure business trust? It may be contended, and probably correctly, that many of such advantages can be had by proper provisions in the declaration of trust. It is a fact, however, that most declarations are entirely silent on many such matters, and to provide for them would require close analysis of the corporation laws and result in the trust instrument being a resumé thereof. Consistent application of the attitude taken on corporations will considerably narrow the field of business trusts. Many other doubts will arise in a particular state. For example, in Minnesota, are the certificates transferable? Are the beneficiaries sufficiently definite?

All organizations referred to as business trusts face a dilemma. On the one hand is the possibility of failing as pure trusts be-

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62The amount of beneficial interests of a trust is determined by the creator of the trust and unless the declaration expressly authorizes the trustees to increase, it is probable that they do not have such power even though the business will suffer for lack of additional capital. And giving such right to the trustees may defeat the organization as a trust.

63In Gardner v. Gardner, (1912) 212 Mass. 508, 99 N.E. 95, it was held that a trustee could issue additional shares of stock to holders of preferred stock to pay up arrears on their preferred dividends even though there be no funds which could be considered as profits, undivided earnings or accumulated surplus sufficient to meet the disbursements.

64Some courts have held that power in the beneficiaries to terminate a trust is fatal. See cases in note 29.

65Minn., G.S. 1913, sec. 6718.

66Dunnell's Minnesota Digest, sec. 9885.
cause of the addition of some desired advantage. On the other are the restrictions of the trust laws, if a pure trust. In the hands of the promoter and organizer of new enterprises the business trust is of no value unless it can be dressed up to look like a corporation and to have many of the advantages which appeal to the prospective purchaser of securities. Stripped of these and so organized as to be in fact a pure trust the organization loses its charm and cannot be sold on its merits. That these organizations are not misrepresented to the investing public and do not mask under false colors is a duty which falls squarely on blue sky administrators.

Aside from the problems which blue sky laws should properly raise there are the further possibilities of being regarded as pure trusts in one state and of failing as such in another, of being a corporation in one and precluded from doing business, and of not being a corporation in another, of being regarded as a trust company and subject to trust company statutes in one state and not in another. All of these are substantial difficulties and are matters on which the courts are still in conflict and which will preclude business trusts from being resorted to by legitimate business to any considerable extent. The writer disagrees with the prediction in an article by R. J. Powell,67 to the effect that the business trust is succeeding the corporation, and believes that as blue sky bodies and the courts are called upon to consider such organizations the present wave will subside and the use of the declaration of trust for business purposes will return to more narrow limits. This does not say that pure trusts cannot be validly formed and that there are not many instances in which their use is proper. Considerable litigation is in prospect, however, before the modern business trust is securely established and its scope of usefulness defined.