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TRUST MANAGEMENT CONTRACT IN THE COMMON LAW SYSTEM

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ABSTRACT

Trusts have long served an important role in Common Law legal systems as a mechanism to hold and manage assets on behalf of beneficiaries. The terms and operation of a trust are outlined in a trust deed created by the settlor. However, trusts have also proven at times to be rigid and inflexible when circumstances change in unforeseen ways not addressed in the original deed. This has led to efforts to reform trust law and administration to build in greater flexibility [1]. One method is through the inclusion of a trust management contract alongside the trust deed to provide guidance to trustees on executing their duties in a way the settlor would have wanted. This article examines the use of trust management contracts under Common Law and their implications for trust governance and operation compared to relying solely on a trust deed.

Keywords: *Trust Management Contract, Common Law System, Fiduciary Duty, Trustee, Settlor, Beneficiary, Trust Property, Trustee's Powers and Duties, Implied Terms, Good Faith*

INTRODUCTION

A trust refers to a fiduciary arrangement where a trustee holds and manages assets on behalf of beneficiaries [2]. It is a mechanism for a settlor to arrange for property to be used to benefit others, typically family members. The Common Law system recognizes two general types of trusts – fixed trusts which impose fixed obligations on trustees with limited flexibility, and discretionary trusts which provide trustees more discretion over distributions and investments [3].

A trust deed is a legal document that establishes the trust and outlines key terms such as naming beneficiaries, specifying trustee powers and duties, setting rules for distributions, and defining processes for appointing and removing trustees [4]. The deed may also outline administrative details related to managing the trust and its assets over time. A well-drafted trust deed strives to put effective arrangements in place to govern operation of the trust over potentially long time periods as circumstances change.

However, trust deeds often fail to fully anticipate issues that may emerge years into administration of a trust. As a result, reform efforts have focused on mechanisms to build greater flexibility into trust governance [5]. Trust management contracts have been one method that allows settlors to provide legally binding guidance separate from the trust deed on how trustees should execute their duties in specified situations. This gives trustees direction when the deed alone may be unclear or fail to address novel circumstances.

Key Attributes of Trust Management Contracts

A trust management contract, sometimes called a trust administration contract or trust governance contract, is a legally binding document between a settlor and trustees that exists alongside the trust deed [6]. It covers areas where the settlor wants to provide guidance, conditions, and pre-authorized actions to the trustees to ensure the trust operates as intended [7]. The contract allows settlors to provide legally enforceable direction on how discretion should be exercised on issues not addressed in the trust deed.

Contracts offer greater flexibility than amending the trust deed itself because changes can be made without needing to alter the underlying trust structure [8]. They allow additional guidance to binding on trustees without rewriting the trust document, which may not even be possible if the settlor is no longer living or capable.

Key attributes and provisions often included in trust management contracts include [9]:

- Guidance on matters not addressed in trust deed – Provides direction on issues emerging over the trust’s lifetime that could not be anticipated such as technology changes affecting administration or asset management.

- Investment criteria and strategy – Lays out investment goals, risk tolerance, asset allocation, and other guidelines trustees must consider. Allows settlors to have input on investment approach.

- Standards for exercise of discretion – Defines when and how trustee discretion should be exercised on distributions, asset use, sale of property, and other decisions.

- Trustee appointment and succession process – Provides clear process and criteria for appointment, resignation and replacement of trustees over time.

- Governing law and jurisdiction – Establishes legal system and jurisdiction for interpreting and enforcing contract terms.

- Amendment process – Lays out how contract can be amended by trustees and any limited rights of settlor or beneficiaries to amend.

- Trustee reporting requirements – Defines what information trustees must provide to beneficiaries such as notification of changes, accounting statements, meeting minutes, etc.
- Trustee duties and standard of care – Codifies expectations around duties, standard of care, loyalty, and performance expectations.
- Conditions for trust termination – Specifies any situation that could trigger early termination such as gross misconduct or failure to produce required reporting.

The common thread across these examples is the contract providing supplemental binding guidance to empower trustees to be adaptable when ambiguous provisions or unforeseeable events might otherwise paralyze decision-making and administration.

Global Perspectives on Trust Contract Uptake

The concept of trust management contracts originated in the late 1900s in jurisdictions such as Jersey, an island in the English Channel where trust law has evolved extensively [11]. The idea remained relatively obscure and unknown until the late 1900s and early 2000s when legislation began adopting frameworks specifically enabling supplemental trust contracts [12]. These statutory developments overcame skepticism about whether such contracts represented improper delegations of trustee duties.

Today, trust contracts have seen expanding international uptake, though global adoption remains uneven and the concept faces ongoing distrust in some jurisdictions. In civil law countries, enhancement mechanisms more akin to trust contracts have also emerged to address trust inflexibility concerns such as “reference arrangements” [13].

Leading jurisdictions embracing trust contracts through some combination of legislation and legal precedent accepting their validity include islands and territories such as Jersey, Guernsey, Gibraltar, Cayman Islands, and Belize. Trust contracts have also gained recognition in New Zealand and some Canadian provinces while uptake has been more limited in other Commonwealth countries like England, Australia, and Singapore [14]. Reasons cited for lagging adoption include prohibitive perpetuities rules limiting contractual guidance timeframe, tax implications constraining inclusion of certain provisions, and cultural biases favoring positional trusts [15].

In the United States, a key development was promulgation of the Uniform Trust Code in 2000 which gave national momentum to modernizing trust law, including providing a path to legitimizing supplemental trust contracts [16]. The UTC has now been adopted fully or partially by over half of states. However, persistent jurisdictional variations in trust law continue to contribute to uneven adoption of management contracts. Looking ahead, expanded state adoption of enabling statutes modelled after the UTC providing a clear framework for validation and enforcement of trust contracts may support wider uptake.

Use Cases and Applications

Trust management contracts provide settlors flexibility to customize trust arrangements separate from the underlying deed to align with their values and goals for the trust assets and beneficiaries. They have proven useful in addressing a variety of common issues that emerge over a trust's lifetime [10]. Some examples include:

Sudden wealth infusion – If a trust receives an unexpected infusion of assets such as an inheritance or litigation payout, a contract can provide guidance on investment and distributions tailored for the new assets that differs from treatment of original assets.

Business interests – If a trust holds ownership in a family business, guidance may be needed on business succession planning, professional management, partial liquidations, and other issues to balance business and beneficiary needs over generations.

Asset restructuring – Contract terms can facilitate corporate restructurings, asset transfers between trusts, or other complex transactions needed to optimize management as economic conditions evolve.

Beneficiary management – Detailed standards around qualifying for distributions linked to education, life events, character requirements or incentive structures promote alignment with settlor values.

Special needs beneficiaries – Customized beneficiary-specific guidance facilitates effective financial support for beneficiaries with disabilities, addiction issues, or other special needs without amending deed.

Dynasty planning – Long-term multi-generational trusts require greater flexibility to foreseeably adapt over an extended time frame to balance continuity and change.

Technology impacts – Emerging technologies like cryptocurrencies and AI/algorithms shaping investing require guidance customized to leverage opportunities they provide.

Tax optimization – As tax regimes evolve, flexibility on domicile changes, asset structuring and distribution policies can support tax efficient operation.

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Trust Contract Legal Validity and Enforceability

A key issue examined in jurisdictions adopting legislation and legal precedent on trust contracts is analyzing validity and enforceability considerations. Analysis weighs protecting legal integrity of the trust structure itself and trustee duties defined under trust law against realizing benefits supplemental contracts confer through added flexibility in administration.

In assessing enforceability, some key considerations include [17]:

- Contract exercise contingent on trustee discretion – Terms do not supersede trustee power but guide how discretion should be exercised. Trustee retains decision rights.

- No conflict with trust purpose or terms – Guidance should align with overall trust purpose rather than fundamentally alter it.

- No unlawful delegation of duties – Contract provides direction not delegation to third parties. Trustee remains legally responsible.

- No legal cap on trustee duties – Legally required minimum trustee duties under trust law remain intact. Contract addresses supplemental areas only trustees could already define policy on.

- Uphold fiduciary loyalty and conflicts of interest – Cannot override base level trustee obligations around loyalty, conflicts of interest etc. aimed at beneficiary protections.

- Contract formation process – Requirements such as trustee consent and settlor capacity protect legal validity.

To provide legal grounding for enforceability, courts in adopting jurisdictions have ruled trust contracts satisfy these criteria related to maintaining integrity of trust structure while facilitating administration over time in way impossible to comprehensively specify at trust creation [18]. Contracts supplement but cannot fundamentally conflict with or undermine trustee authority and obligations under governing trust law. Jurisdictions also increasingly specify that trustees must provide written acknowledgement when accepting contract provisions that they understand associated responsibility [19].

Looking ahead, an area requiring further guidance is beneficiary rights related to trust contracts which remain poorly defined in many jurisdictions [20]. For example, guidelines are needed on whether beneficiaries can legally access contract terms given their interest in administration, if they can pursue breach claims, and if they hold any limited participation rights in contract formation or amendments. Clarifying standing recognizes beneficiaries bear impacts of contract operation.

Drafting Effective Trust Contract Provisions

Within jurisdictions where trust contracts have legal standing, attention has turned to guidance on drafting effective contracts that adhere to enforceability requirements while maximizing flexibility value [21]. Recommendations around planning and drafting provisions emphasize [22]:

Clearly stating intent – Be explicit Contract exists to provide supplemental but binding guidance to trustees on administration issues not addressed in trust deed.

Defining contractual parties – Name trustees and any trust protectors or advisers as parties subject to provisions. Approval and consent processes should verify all parties agree to administration guidance.

Specifying trustees must acknowledge – Require trustees provide signed acknowledgement of contract terms and associated accountability.

Linking contract and trust deed terms – Reference trust deed directly and note contract provides additional enforceable conditions trustees most consider when exercising discretionary judgement in identified areas.

Granting amendment authority – Outline procedures for amending contract over time to retain relevance. Amendment processes should balance settlor protection for initial trust purpose with flexibility to modify approaches over extended durations.

Addressing governing law – Establish law that will govern contract interpretation and enforcement to ensure consistency in application.

Analyzing trustee and beneficiary rights – Assess standing of all parties impacted by contract across areas like access to terms, enforcement capacity, and consent processes.

Reviewing contract periodically – Build in expectations for trustees to revisit guidance periodically to validate consistency with current trust administration context or determine if amendments are appropriate.

Taken together, strong drafting principles ensure contracts optimized to deliver administration guidance across projected trust duration without undermining trust structure or trustee fiduciary duties. Ongoing review and refinement is encouraged as use of trust contracts continues evolving in jurisdictions globally.

CONCLUSION

Trust management contracts represent an important evolution in trust law enabling supplementary binding guidance customized by settlors to facilitate administration over time as circumstances evolve. When thoughtfully crafted, trust contracts can provide trustees legally enforceable direction on exercising discretion related to investments, distributions, succession planning and other issues that may emerge over extended trust lifetimes. Trust contracts uphold integrity of core trust structure while introducing targeted flexibility where most useful.

Looking ahead, continued adoption of clear legal frameworks for validating and enforcing trust contracts across Common Law jurisdictions globally remains critical for wider adoption. As uptake grows, analysis of optimal contract scope and provisions is likely to continue unfolding. But jurisdictions where trust contracts have gained early legal grounding provide models highlighting significant value potential from supplemental trust contracts alongside declarations for advisors and policymakers continuing to shape trust law modernization pathways. With enabling legislation now enacted across multiple Common Law countries and states, the stage appears set for trust contracts to potentially transition over the next decade from an obscure novelty to a broadly embraced enhancement strengthening trust functionality.

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