

D R A F T
FOR APPROVAL

**AMENDMENTS TO
UNIFORM PRINCIPAL AND INCOME ACT
SECTION 105**

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

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UNIFORM PRINCIPAL AND INCOME ACT
SECTION 105**

WITH COMMENTS

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ON UNIFORM STATE LAWS

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POWERS.

(a) A court shall not change a fiduciary's decision to exercise or not to exercise a discretionary power conferred by this [Act] unless it determines that the decision was an abuse of the fiduciary's discretion. A court shall not determine that a fiduciary abused its discretion merely because the court would have exercised the discretion in a different manner or would not have exercised the discretion.

(b) The decisions to which subsection (a) applies include:

(1) A determination under Section 104(a) of whether and to what extent
an amount should be transferred from principal to income or from income to
principal.

(2) A determination of the factors that are relevant to the trust and its beneficiaries, the extent to which they are relevant, and the weight, if any, to be given to the relevant factors, in deciding whether and to what extent to exercise the power conferred by Section 104(a).

(c) If a court determines that a fiduciary has abused its discretion, the remedy is to restore the income and remainder beneficiaries to the positions they would have occupied if the fiduciary had not abused its discretion, according to the following rules:

1 (1) To the extent that the abuse of discretion has resulted in no
2 distribution to a beneficiary or a distribution that is too small, the court shall require
3 the fiduciary to distribute from the trust to the beneficiary an amount that the court
4 determines will restore the beneficiary, in whole or in part, to his or her appropriate
5 position.

6 (2) To the extent that the abuse of discretion has resulted in a
7 distribution to a beneficiary that is too large, the court shall restore the beneficiaries,
8 the trust, or both, in whole or in part, to their appropriate positions by requiring the
9 fiduciary to withhold an amount from one or more future distributions to the
10 beneficiary who received the distribution that was too large or requiring that
11 beneficiary to return some or all of the distribution to the trust.

12 (3) To the extent that the court is unable, after applying paragraphs (1)
13 and (2), to restore the beneficiaries, the trust, or both, to the positions they would
14 have occupied if the fiduciary had not abused its discretion, the court may require
15 the fiduciary to pay an appropriate amount from its own funds to one or more of the
16 beneficiaries or the trust or both.

17 (d) Upon a petition by the fiduciary, the court having jurisdiction over the
18 trust or estate shall determine whether a proposed exercise or nonexercise by the
19 fiduciary of a discretionary power conferred by the [Act] will result in an abuse of
20 the fiduciary's discretion. If the petition describes the proposed exercise or
21 nonexercise of the power and contains sufficient information to inform the
22 beneficiaries of the reasons for the proposal, the facts upon which the fiduciary

1 relies, and an explanation of how the income and remainder beneficiaries will be
2 affected by the proposed exercise or nonexercise of the power, a beneficiary who
3 challenges the proposed exercise or nonexercise has the burden of establishing that it
4 will result in an abuse of discretion.

5 [Subsequent sections will be renumbered]

6 **Comment**

7 **General.** All of the discretionary powers in the 1997 Act are subject to the
8 normal rules that govern a fiduciary's exercise of discretion. Section 105 codifies
9 those rules for purposes of the Act so that they will be readily apparent and
10 accessible to fiduciaries, beneficiaries, their counsel and the courts if and when
11 questions concerning such powers arise.

12 Section 105 also makes clear that the normal rules governing the exercise of
13 a fiduciary's powers apply to the discretionary power to adjust conferred upon a
14 trustee by Section 104(a). Discretionary provisions authorizing trustees to
15 determine what is income and what is principal have been used in governing
16 instruments for years; Section 2 of the 1931 Uniform Principal and Income Act
17 recognized that practice by providing that "the person establishing the principal may
18 himself direct the manner of ascertainment of income and principal...or grant
19 discretion to the trustee or other person to do so" Section 103(a)(2)
20 recognizes the power of a settlor to grant such discretion to the trustee; Section 105
21 applies to a discretionary power granted by the terms of a trust or a will and to the
22 power to adjust in Section 104(a).

23 The exercise of the power to adjust is governed by a trustee's duty of
24 impartiality, which requires the trustee to strike an appropriate balance between the
25 interests of the income and remainder beneficiaries. Section 103(b) expresses this
26 duty by requiring the trustee to "administer a trust or estate impartially, based on
27 what is fair and reasonable to all of the beneficiaries, except to the extent that the
28 terms of the trust or the will clearly manifest an intention that the fiduciary shall or
29 may favor one or more of the beneficiaries." Because this involves the exercise of
30 judgment in circumstances rarely capable of perfect resolution, trustees are not
31 expected to achieve perfection; they are, however, required to make conscious
32 decisions in good faith and with proper motives.

33 In seeking the proper balance between the interests of the beneficiaries in
34 matters involving principal and income, a trustee's traditional approach has been to
35 determine the settlor's objectives from the terms of the trust, gather the information

1 needed to ascertain the financial circumstances of the beneficiaries, determine the
2 extent to which the settlor's objectives can be achieved with the resources available
3 in the trust, and then allocate the trust's assets between stocks and fixed-income
4 securities in a way that will produce a particular level or range of income for the
5 income beneficiary. The key element in this process has been to determine the
6 appropriate level or range of income for the income beneficiary, and that will
7 continue to be the key element in deciding whether and to what extent to exercise
8 the discretionary power conferred by Section 104(a). If it becomes necessary for a
9 court to determine whether an abuse of the discretionary power to adjust between
10 principal and income has occurred, the criteria should be the same as those that
11 courts have used in the past to determine whether a trustee has abused its discretion
12 in allocating the trust's assets between stocks and fixed-income securities.

13 **General rule.** The first sentence of Section 105(a) is from Restatement
14 (Second) of Trusts § 187 and Restatement (Third) of Trusts (Tentative Draft No. 2,
15 1999) § 50(1). The second sentence of Section 105(a) derives from Comment *e* to
16 § 187 of the Second Restatement and Comment *b* to § 50 of the Third Restatement.

17 The reference in Section 105(a) to a fiduciary's decision to exercise or not to
18 exercise a discretionary power underscores a fundamental precept, which is that a
19 fiduciary has a duty to make a conscious decision about exercising or not exercising
20 a discretionary power. Comment *b* to § 50 of the Third Restatement states:

21 [A] court will intervene where the exercise of a power is left to the judgment of
22 a trustee who improperly fails to exercise that judgment. Thus, even where a
23 trustee has discretion whether or not to make any payments to a particular
24 beneficiary, the court will interpose if the trustee, arbitrarily or without
25 knowledge of or inquiry into relevant circumstances, fails to exercise the
26 discretion.

27 Section 105(b) makes clear that the rule of subsection (a) applies not only to
28 the power conferred by Section 104(a) but also to the evaluation process required
29 by Section 104(b) in deciding whether and to what extent to exercise the power to
30 adjust. Under Section 104(b), a trustee is to consider all of the factors that are
31 relevant to the trust and its beneficiaries, including, to the extent the trustee
32 determines they are relevant, the nine factors enumerated in Section 104(b). Section
33 104(b) derives from Section 2(c) of the Uniform Prudent Investor Act, which lists
34 eight circumstances that a trustee shall consider, to the extent they are relevant, in
35 investing and managing assets. The trustee's decisions about what factors are
36 relevant for purposes of Section 104(b) and the weight to be accorded each of the
37 relevant factors are part of the discretionary decision-making process. As such,
38 these decisions are not subject to change for the purpose of changing the trustee's

1 ultimate decision unless the court determines that there has been an abuse of
2 discretion in determining the relevancy and weight of these factors.

3 **Remedy.** The exercise or nonexercise of a discretionary power under the
4 Act normally affects the amount or timing of a distribution to the income or
5 remainder beneficiaries. The primary remedy under Section 105(c) for abuse of
6 discretion is the restoration of the beneficiaries and the trust to the positions they
7 would have occupied if the abuse had not occurred. It draws on a basic principle of
8 restitution that if a person pays money to someone who is not intended to receive it
9 (and in a case to which this Act applies, not intended by the settlor to receive it in
10 the absence of an abuse of discretion by the trustee), that person is entitled to
11 restitution on the ground that the payee would be unjustly enriched if he were
12 permitted to retain the payment. See Restatement of Restitution § 22 (1937). The
13 objective is to accomplish the restoration initially by making adjustments between
14 the beneficiaries and the trust to the extent possible; to the extent that restoration is
15 not possible by such adjustments, a court may order the trustee to pay an amount to
16 one or more of the beneficiaries, the trust, or both the beneficiaries and the trust. If
17 the court determines that it is not possible in the circumstances to restore them to
18 their appropriate positions, the court may provide other remedies appropriate to
19 the circumstances. The approach of Section 105(c) is supported by Comment *b* to
20 § 50 of the Third Restatement of Trusts:

21 When judicial intervention is required, a court may direct the trustee to make or
22 refrain from making certain payments; issue instructions to clarify the standards
23 or guidelines applicable to the exercise of the power; or rescind the trustee's
24 payment decisions, usually directing the trustee to recover amounts improperly
25 distributed and holding the trustee liable for failure or inability to do so....

26 **Advance determinations.** Section 105(d) employs the familiar remedy of
27 the trustee's petition to the court for instructions. It requires the court to determine,
28 upon a petition by the fiduciary, whether a proposed exercise or nonexercise of a
29 discretionary power by the fiduciary of a power conferred by the Act would be an
30 abuse of discretion under the general rule of Section 105(a). If the petition contains
31 the information prescribed in the second sentence of subsection (d), the proposed
32 action or inaction is presumed not to result in an abuse, and a beneficiary who
33 challenges the proposal must establish that it will.

34 Subsection (d) is intended to provide a fiduciary the opportunity to obtain an
35 assurance of finality in a judicial proceeding before proceeding with a proposed
36 exercise or nonexercise of a discretionary power. Its purpose is not, however, to
37 have the court instruct the fiduciary how to exercise the discretion.

1 A fiduciary may also obtain the consent of the beneficiaries to a proposed act
2 or an omission to act, and a beneficiary cannot hold the fiduciary liable for that act
3 or omission unless:

4 (a) the beneficiary was under an incapacity at the time of such consent or of
5 such act or omission; or

6 (b) the beneficiary, when he gave his consent, did not know of his rights and
7 of the material facts which the trustee knew or should have known and which
8 the trustee did not reasonably believe that the beneficiary knew; or

9 (c) the consent of the beneficiary was induced by improper conduct of the
10 trustee.

11 Restatement (Second) of Trusts § 216.

12 If there are many beneficiaries, including some who are incapacitated or
13 unascertained, the fiduciary may prefer the greater assurance of finality provided by
14 a judicial proceeding that will bind all persons who have an interest in the trust.