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211 E. Ontario Street, Suite 1300
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AMENDMENTS TO
UNIFORM PRINCIPAL AND INCOME ACT
SECTION 105

SECTION 105. JUDICIAL CONTROL OF DISCRETIONARY 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) To the extent that the abuse of discretion has resulted in no
distribution to a beneficiary or a distribution that is too small, the court shall require
the fiduciary to distribute from the trust to the beneficiary an amount that the court
determines will restore the beneficiary, in whole or in part, to his or her appropriate
position.

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

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

(d) Upon a petition by the fiduciary, the court having jurisdiction over the
trust or estate shall determine whether a proposed exercise or nonexercise by the
fiduciary of a discretionary power conferred by the [Act] will result in an abuse of
the fiduciary’s discretion. If the petition describes the proposed exercise or
nonexercise of the power and contains sufficient information to inform the
beneficiaries of the reasons for the proposal, the facts upon which the fiduciary
relied, and an explanation of how the income and remainder beneficiaries will be
affected by the proposed exercise or nonexercise of the power, a beneficiary who
challenges the proposed exercise or nonexercise has the burden of establishing that it
will result in an abuse of discretion.

[Subsequent sections will be renumbered]

Comment

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

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

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

In seeking the proper balance between the interests of the beneficiaries in
matters involving principal and income, a trustee’s traditional approach has been to
determine the settlor’s objectives from the terms of the trust, gather the information
needed to ascertain the financial circumstances of the beneficiaries, determine the
extent to which the settlor’s objectives can be achieved with the resources available
in the trust, and then allocate the trust’s assets between stocks and fixed-income
securities in a way that will produce a particular level or range of income for the
income beneficiary. The key element in this process has been to determine the
appropriate level or range of income for the income beneficiary, and that will
continue to be the key element in deciding whether and to what extent to exercise
the discretionary power conferred by Section 104(a). If it becomes necessary for a
court to determine whether an abuse of the discretionary power to adjust between
principal and income has occurred, the criteria should be the same as those that
courts have used in the past to determine whether a trustee has abused its discretion
in allocating the trust’s assets between stocks and fixed-income securities.

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

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

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

Section 105(b) makes clear that the rule of subsection (a) applies not only to
the power conferred by Section 104(a) but also to the evaluation process required
by Section 104(b) in deciding whether and to what extent to exercise the power to
adjust. Under Section 104(b), a trustee is to consider all of the factors that are
relevant to the trust and its beneficiaries, including, to the extent the trustee
determines they are relevant, the nine factors enumerated in Section 104(b). Section
104(b) derives from Section 2(c) of the Uniform Prudent Investor Act, which lists
eight circumstances that a trustee shall consider, to the extent they are relevant, in
investing and managing assets. The trustee’s decisions about what factors are
relevant for purposes of Section 104(b) and the weight to be accorded each of the
relevant factors are part of the discretionary decision-making process. As such,
these decisions are not subject to change for the purpose of changing the trustee’s
ultimate decision unless the court determines that there has been an abuse of
discretion in determining the relevancy and weight of these factors.

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

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

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

Subsection (d) is intended to provide a fiduciary the opportunity to obtain an
assurance of finality in a judicial proceeding before proceeding with a proposed
exercise or nonexercise of a discretionary power. Its purpose is not, however, to
have the court instruct the fiduciary how to exercise the discretion.
A fiduciary may also obtain the consent of the beneficiaries to a proposed act or an omission to act, and a beneficiary cannot hold the fiduciary liable for that act or omission unless:

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

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

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

Restatement (Second) of Trusts § 216.

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