

## Title

Is there a practical difference between Equitable Deviation and *Cy Pres* when it comes to seeking modification under the Uniform Trust Code of a charitable trust's administrative term?

## Summary

Assume an income-only charitable trust with the following administrative term: The trustee may only invest in “insured bank accounts and government securities.” Section 412(b) of the Uniform Trust Code (UTC) provides that a “[t]he court may modify the administrative terms of a trust if continuation of the trust on its existing terms would be impracticable or wasteful or impair the trust’s administration.” According to the official comment to Section 413 of the UTC, which purports to codify *cy pres* doctrine, the *cy pres* power may be applied to modify the administrative terms of a trust. Assume that the investment restriction is subverting the trust’s charitable purposes. The practical difference between the UTC §412 remedy and the UTC §413 remedy in this context is not all that easy to discern. See, for what it is worth, *In re Estate of Chamberlin*, 23 N.Y.S.3d 658, 2016 N.Y. Slip Op. 00087 (2016) (the court modifying such an investment restriction via an application of New York’s homegrown equitable deviation statute). Equitable deviation doctrine is taken up generally in §8.15.20 of *Loring and Rounds: A Trustee’s Handbook* (2016). Section 8.15.20 is reproduced in its entirety below.

## Text

### **§8.15.20 Doctrine of Equitable Deviation** [from *Loring and Rounds: A Trustee’s Handbook* (2016), with post-publication enhancements]

*The rationale for modifying a donative document is that the donor would have desired the modification to be made if he or she had realized that the desired tax objectives would not be achieved. A similar rationale underlies the cy pres doctrine for charitable trusts, the deviation doctrine for private trusts, and the special-purpose reformation doctrine for curing perpetuity violations.*<sup>441</sup>

**The traditional doctrine.** Under the doctrine of equitable deviation, a court may effect a change in the express administrative provisions of a trust in order to accomplish the trust's express purpose.<sup>442</sup> Courts generally require both an unforeseen and unforeseeable change in circumstances<sup>443</sup> and a “frustration of...[the]...settlor's main objective if the trust conditions are strictly followed”<sup>444</sup> before the

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<sup>441</sup>Restatement (Third) of Property (Donative Transfers) §12.2 (Tentative Draft No. 1, 1995).

<sup>442</sup>See 4A Scott on Trusts §381; Restatement (Second) of Trusts §381; 6 Scott & Ascher §39.5.

<sup>443</sup>See, e.g., *Church of the Little Flower v. U.S. Bank*, 979 N.E.2d 106 (Ill. App. 2012) (“Plaintiff contends equitable deviation is justified because...[the settlor]...could not have foreseen the amendment of the...[charitable]...trust to comply with the private foundation...[tax]...rules. The trust agreement, which directs the trustee to maintain compliance with those rules, plainly refutes that premise.”); *Matter of Trust Under Will of Nobbe*, 831 N.E.2d 835 (Ind. Ct. App. 2005) (the court declining to grant the “extraordinary” relief of equitable deviation, the events that occasioned the litigation having been “anticipated” by the settlor). See generally *Power of court to authorize modification of trust instrument because of changes in tax law*, 57 A.L.R.3d 1044.

<sup>444</sup>*First Nat'l Bank & Trust Co. of Wyo. v. Brimmer*, 504 P.2d 1367, 1370 (Wyo. 1973).

doctrine is applied.<sup>445</sup> The test is not the “best interests” of the beneficiaries; rather the petitioners must establish that the settlor's presumed intent is incapable of fulfillment.<sup>446</sup> “In the case of a private [*i.e.*, noncharitable] trust, . . . the court ordinarily does not substitute new beneficiaries for those designated in the terms of the trust; nor does it ordinarily enlarge the interest of one beneficiary at the expense of another.”<sup>447</sup> New York’s equitable deviation statute applicable to the administrative provisions of charitable trusts does not require that a change in circumstances be unforeseen.<sup>448</sup>

On the other hand, a *cy pres* judgment in the charitable context generally does effect a shifting of equitable or beneficial interests.<sup>449</sup> Thus, in the charitable context, “courts apply equitable deviation to make changes in the manner in which a charitable trust is carried out while courts apply *cy pres* in situations where trustees seek to modify or redefine the settlor's specific charitable purpose.”<sup>450</sup> In the few states that do not recognize *cy pres*, the courts are inclined to apply a “somewhat more robust than usual notion of equitable deviation” to charitable trusts that would otherwise be *cy pres*-eligible.<sup>451</sup>

One court has outlined the general differences between the *cy pres* doctrine<sup>452</sup> and the doctrine of equitable deviation:

The *cy pres* doctrine is a rule of judicial construction under which the court is required to first find a general charitable intent in the instrument creating the trust; the general charitable purpose of the settlor moves the court to substitute a different charitable purpose for the one which has failed. *Cy pres* is applied only in the field of charitable trusts, whereas, *a court of equity may order a deviation in private as well as charitable trusts*. In ordering a deviation a court of equity is merely exercising its general power over the administration of trusts; it is an essential element of equity jurisdiction. In ordering a deviation the court does not touch the question of the purpose or object of the trust, nor vary the class of beneficiaries, nor divert the fund from the charitable purpose designated.<sup>453</sup>

In order to avoid a “defeat or substantial impairment” of a trust's purposes due to a change of circumstances that was unanticipated by the settlor, a court, for example, may in a given situation allow or direct the trustee to sell, mortgage, pledge, or lease the trust property even though the terms of the trust have directed the trustee not to.<sup>454</sup> In cases where the settlor has limited the investment options of the

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<sup>445</sup> See generally 6 Scott & Ascher §39.5. See, e.g., *Church of the Little Flower v. U.S. Bank*, 979 N.E.2d 106 (Ill. App. 2012) (holding that the trial court’s granting of an equitable deviation petition to terminate a split-interest trust upon a finding that the substantial fees that the trustee had been collecting from the trust estate had been interfering with the trust’s charitable purposes was unwarranted in light of the trust’s particular terms).

<sup>446</sup> *In re JP Morgan Chase Bank, N.A.*, 19 Misc.3d 337, 342, 852 N.Y.S.2d 718, 722 (2008).

<sup>447</sup> 6 Scott & Ascher §39.5.

<sup>1</sup> See *In re Estate of Chamberlin*, 23 N.Y.S.3d 658, 2016 N.Y. Slip Op. 00087.

<sup>448</sup> See generally 6 Scott & Ascher §39.5.

<sup>449</sup> *Niemann v. Vaughn Cmty. Church*, 154 Wash. 2d 365, 378, 113 P.3d 463, 469 (2005).

<sup>450</sup> 6 Scott & Ascher §39.5.2.

<sup>451</sup> See generally §9.4.3 of this handbook (*cy pres*).

<sup>452</sup> *Craft v. Shroyer*, 74 N.E.2d 589, 598 (1947). See also *Plummer Memorial Loan Fund Trust v. Nebraska*, 661 N.W.2d 307 (Neb. 2003) (strictly construing the doctrine of *cy pres* and the doctrine of equitable or administrative deviation and finding neither applicable). Cf. UTC §412(b) (available at <<http://www.uniformlaws.org/Act.aspx?title=Trust%20Code>>) (providing that the court may modify the administrative terms of a trust if continuation of the trust on its existing terms would be impracticable or wasteful or impair the trust's administration). See generally 6 Scott & Ascher §39.5.

<sup>453</sup> See generally 3 Scott & Ascher §16.4 (Change of Circumstances). See, e.g., *Niemann v. Vaughn Cmty. Church*, 154 Wash. 2d 365, 113 P.3d 463 (2005) (an equitable deviation action in which the court,

trustee to bonds, some courts have been willing, nonetheless, to expand the trustee's investment options to include common stocks: "Typically, the reason for such a departure is that the proposed investments will act as a hedge against inflation, diversify the trust's portfolio, or improve the trust's overall return."<sup>454</sup>

Equitable deviation is not just for tweaking a trust's investment provisions, as one appellate court has confirmed. In lieu of the eventual outright distribution of the assets of an ongoing trust to the victim of schizophrenia affective disorder and bipolar disorder, which was the mode of terminating distribution called for by the trust's terms, the court, invoking the doctrine of equitable deviation, let it be known that it would uphold a diversion of the distribution to the trustee of a third-party special needs trust established down the road for the benefit of the victim.<sup>455</sup> Circumstances had changed.<sup>456</sup> The deceased settlors had been unaware of their granddaughter's disability and would not have wanted trust assets squandered to no avail, or unnecessarily diverted into the coffers of the state.<sup>457</sup> Third-party special needs trusts are covered in Section 9.3 of this handbook.

**Substantive equitable deviation under the Uniform Trust Code.** The Uniform Trust Code would broaden the court's ability to modify the administrative terms of a trust.<sup>458</sup> The standard is similar to the standard for applying *cy pres* to a charitable trust.<sup>459</sup> "Just as a charitable trust may be modified if its particular charitable purpose becomes impracticable or wasteful, so can the administrative terms of any trust, charitable or noncharitable."<sup>460</sup>

The UTC, specifically Section 412, also would broaden the court's ability to apply equitable deviation to encompass a trust's termination or modification: The court may modify the administrative or dispositive terms of a trust or terminate the trust if, because of circumstances not anticipated by the settlor, modification or termination will further the purposes of the trust.<sup>461</sup> "For example, modification of the dispositive provisions to increase support of a beneficiary might be appropriate if the beneficiary has become unable to provide for support due to poor health or serious injury."<sup>462</sup> The Restatement (Third) of Trusts is generally in accord.<sup>463</sup> The Uniform Prudent Management of Institutional Funds Act (UPMIFA)—which applies to charitable corporations as well as charitable trusts—takes a similarly expansive approach to equitable deviation, but in the charitable context.<sup>464</sup> Invoking the modern doctrine of equitable deviation, one court has authorized the conversion of a preexisting non-self-settled trust to a

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overriding express retention language in the governing trust instrument, authorized the sale of certain entrusted church property, the court finding the property alienation restriction to be administrative rather than integral to the trust's dominant charitable purpose).

<sup>454</sup>See generally 3 Scott & Ascher §16.4 (Change of Circumstances).

<sup>455</sup>In re Riddell, 138 Wash. App. 485, 157 P.3d 888 (2007).

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<sup>458</sup>UTC §412 cmt. (available at <<http://www.uniformlaws.org/Act.aspx?title=Trust%20Code>>).

<sup>459</sup>UTC §412 cmt. (available at <<http://www.uniformlaws.org/Act.aspx?title=Trust%20Code>>).

<sup>460</sup>UTC §412 cmt. (available at <<http://www.uniformlaws.org/Act.aspx?title=Trust%20Code>>).

"Although the settlor is granted considerable latitude in defining the purposes of the trust, the principle that a trust have a purpose which is for the benefit of its beneficiaries precludes unreasonable restrictions on the use of trust property." UTC §412 cmt. "An owner's freedom to be capricious about the use of the owner's own property ends when the property is impressed with a trust for the benefit of others." UTC §412 cmt.

<sup>461</sup>UTC §412(a) (available at <<http://www.uniformlaws.org/Act.aspx?title=Trust%20Code>>).

<sup>462</sup>UTC §412 cmt. §412 cmt. (available at <<http://www.uniformlaws.org/Act.aspx?title=Trust%20Code>>).

<sup>463</sup>Restatement (Third) of Trusts §66(1).

<sup>464</sup>Unif. Prudent Management of Institutional Funds Act §6(b).

special/supplemental needs trust.<sup>465</sup>

Under Oregon’s version of Section 412 of the UTC, the court lacks the power to grant equitable deviation relief *sua sponte*.<sup>466</sup> This is an exception to the general rule that “a court in equity has broad discretion in crafting relief, and the parties in equity are not necessarily limited to the relief that they seek in their complaint.”<sup>467</sup>

*The plain meaning rule.* Has Uniform Trust Code’s Section 412 defanged the plain meaning rule? Not, at least, in Indiana. In *Kristoff v. Centier Bank*, a trust beneficiary, invoking Indiana’s version of Section 412, sought a judicial termination of the trust in mid-course.<sup>468</sup> Circumstances had made it impossible for the trust to function as a GST-avoidance vehicle. The requested termination, however, would have contravened the intentions of the settlor as they had been clearly and unambiguously articulated in the governing instrument. Her request was denied. The denial was upheld on appeal. The instrument’s dispositive provisions being clear and unambiguous, namely that tax avoidance was not the trust’s only purpose, the court declined to consider extrinsic evidence that might have suggested that the settlor’s dispositive wishes were something other than what had been expressed in the writing. That others as well as the petitioner had contingent equitable interests under the trust did not help her case. The plain meaning rule is covered generally in Section 8.15.6 of this handbook.

*The role of the courts.* If the circumstances are such that the court would authorize an equitable deviation from the terms of the trust, then the trustee would seem to have the inherent authority to do so without court approval.<sup>469</sup> The problem is that the only way for the trustee to know for sure what a court would actually do when presented with a given set of facts is to ask it, which would likely entail initiating some type of judicial proceeding, be it a complaint for instructions,<sup>470</sup> a complaint for declaratory judgment,<sup>471</sup> or perhaps a petition to have his accounts allowed.<sup>472</sup> This can generally be done at trust expense.<sup>473</sup> A trustee who proceeds to deviate from the terms of the trust without first seeking judicial approval to do so assumes the risk that some court down the road will determine that deviation was not warranted, that the trust was somehow harmed as a result of the trustee’s actions, and that the trustee must use his personal funds to remedy the situation.<sup>474</sup> In lieu of seeking judicial permission, the trustee might attempt to attain the consent of all beneficiaries. If there are unborn and unascertained remaindermen, however, as is likely to be the case, then the nonjudicial approach is probably not an option.<sup>475</sup> Nor in some cases is inaction: “If there has been such a change of circumstances that compliance with the terms of the trust would defeat or substantially impair the trust purposes, the trustee cannot sit idly by and do nothing to prevent the loss.”<sup>476</sup>

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<sup>465</sup> See *In re Riddell*, 157 P.3d 888 (Wash. Ct. App. 2007). Cf. §9.3 of this handbook (the self-settled “special needs”/“supplemental needs” trust).

<sup>466</sup> See *Head v. Head*, 323 P.3d 505 (Or. Ct. App. 2014).

<sup>467</sup> *Head v. Head*, 323 P.3d 505, 510 (Or. Ct. App. 2014).

<sup>468</sup> *Kristoff v. Centier Bank*, 985 N.E.2d 20 (Ind. App. 2013).

<sup>469</sup> See generally 3 Scott & Ascher §16.4.1.

<sup>470</sup> See generally §8.42 of this handbook (what is the difference between a complaint (petition) for instructions and a complaint (petition) for declaratory judgment?).

<sup>471</sup> See generally §8.42 of this handbook (what is the difference between a complaint (petition) for instructions and a complaint (petition) for declaratory judgment?).

<sup>472</sup> See generally §6.1.5.2 of this handbook (duty to keep and render accounts).

<sup>473</sup> See generally §3.5.2.3 of this handbook (discussing the trustee’s right in equity to exoneration and reimbursement).

<sup>474</sup> See generally 3 Scott & Ascher §16.4.1.

<sup>475</sup> See generally §8.14 of this handbook (when a guardian ad litem (or special representative) is needed: virtual representation issues).

<sup>476</sup> 3 Scott & Ascher §16.4.2.

*The posture of the trustee in a contested substantive equitable deviation action.* In the face of the trustee's duty to defend his trust, a topic we take up generally in Section 6.2.6 of this handbook, it is hard to see how a trustee can properly maintain a neutral posture in a contested substantive equitable deviation action, particularly if some but not all of the beneficiaries are seeking to reorder and/or diminish the ostensible equitable property rights of their cobeneficiaries, and even more so if the terms of the trust are patently and latently unambiguous. At trust expense the trustee should mount a vigorous opposition to the action, unless to do so would be unreasonable; and the trustee certainly should not initiate it, as to do so would most assuredly implicate the trustee's duty of impartiality, a topic we take up generally in Section 6.2.5 of this handbook.

**Doctrinal analogues.** The doctrines of *cy pres*<sup>477</sup> and equitable deviation should not be confused with the variance power granted the trustees of a charitable foundation in its governing documentation.<sup>478</sup>

It is not entirely clear what the practical difference is between UTC substantive equitable deviation and UTC substantive equitable reformation. The latter topic we take up in Section 8.15.22 of this handbook.

Is it possible to alter a trust term via a trust-to-trust decanting? Decanting as an alternative to the reformation or deviation action in the trust context is taken up in Section 3.5.3.2(a) of this handbook.

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<sup>477</sup> See generally 6 Scott & Ascher §39.5 (*cy pres*); §9.4.3 of this handbook (*cy pres*).

<sup>478</sup> The concept of a variance power is discussed in §8.15.37 of this handbook.