

CENTER FOR EXCELLENCE IN HIGHER EDUCATION CONFERENCE

DONOR INTENT AND THE FUTURE OF HIGHER EDUCATION PHILANTHROPY

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“Ne trustez personne,” Hercule Poirot

A recent letter to the editor of The Chronicle of Philanthropy implored donors to higher education to trust the donees.² Obviously, if those donees were entirely trustworthy, such a letter would have been unnecessary.

Until quite recently, neither donors nor donees paid much attention to donors' rights. That appears to be changing,³ and it's about time.

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² Erica Seth, Letters to the Editor, Don't Undermine Donors' Trust, Chronicle of Philanthropy, Nov. 15, 2007, <http://www.philanthropy.com/premium/articles/v20/i03/03004202.htm>. Contra, Stephanie Strom, Donors Gone, Trusts Veer From Their Wishes, N.Y. Times, Sept. 29, 2007, at A1 & A12.

³ Evelyn Brody, Esq., Professor of Law at Chicago-Kent College of Law, is the reporter for the American Law Institute's ongoing Principles of the Law of Nonprofit Organizations of which some Preliminary or Tentative Drafts have been published. Evelyn has recently published a comprehensive and valuable article, From the Dead and to the Living Dead: The Conundrum of Charitable-Donor Standing, 41 Georgia L. Rev. 1183 (2007) (hereafter "Evelyn"). It behooves especially donors to read Evelyn's article, all 93 pages, and to track the development of the Principles which certainly will influence the development of the law of donor's rights in particular as well as nonprofit law in general.

If settlors -- those who create non-charitable trusts -- create a living or a testamentary trust with a trust company for the benefit of Ron Malone, and the trustee breaches the trust, can the creators enforce it? Can their legal representatives? Can their heirs? Who can?

If donors, *inter vivos* or by will, create a charitable trust in favor of a designated charitable beneficiary, and the trustee breaches the trust, can they enforce it? Can their legal representatives or heirs? Who can?

If donors, *inter vivos* or by will, create a charitable trust in which the trustee has plenary discretion as to income and principal investments and distributions and if the trustee makes an expenditure for a non-charitable purpose, can anyone enforce the trust?

If donors create a private foundation of which they are not “foundation managers”, do they have any rights with respect to its actions?

If The Ford Foundation, a private foundation, makes a grant, and if the grantee does not do what it undertook to do, has a contract been breached for which the law will provide a remedy? What remedy?

If the United States or a state or city or agency thereof makes the same grant, is the result different?

If Jane and John Doe, a married couple, jointly make a grant to a hospital for the purchase of a building for a specific treatment facility, and the hospital fails to

carry out the grant or changes the use, does the law provide a remedy? If one of them dies, does that change the result? If both die, does that change the result? What remedy?

If, instead of an *inter vivos* grant, the same donors make bequests for the same purpose in their wills, and if the hospital accepts the bequests, but does not carry them out or change the use, can the donors' legal representatives enforce the bequest? Can the donors' heirs?

If the hospital changes the use of the facility or sells it and does not use or buy another for the same purpose, has it breached the grant in a way for which the law provides a remedy? If so, who can enforce? What is that remedy?

If, in connection with the grant to the hospital for the purchase of the treatment facility, the donors also provide an endowment for its maintenance and operation, does that change the result?

I have ten minutes for this talk, so I'm not going to even try to answer all these questions, for some, perhaps for many, of which there may not yet be any settled answers. Instead, I'm going to tell you three stories from my career which may suggest some answers to some of these questions.

1. Why Donors Need Contracts. After an awful experience with a major university, the endowment I later did for a client for a school at another major

university runs to more than 30 pages, a trend which Evelyn, I think, may deplore⁴, but which I think is both inevitable and necessary. The situation is worth describing, because the form of the original agreement, which I did not do, a match, is very common, yet, I think, not discussed in Evelyn's article nor at least yet in the Principles.

A family foundation agreed to endow a specific university facility's maintenance fund, if the university would, over a specified time, match. The family had previously funded the facility. The university failed to make the match. Its time was extended. It still failed to make the match, even though the foundation had fully performed. Only the threat of litigation produced a result, though it was not entirely satisfactory.

2. Can Donors Rely on Attorneys General? As I have written her, Evelyn does not discuss the Smithers case⁵ exactly the way I would discuss it.

R. Brinkley Smithers, a recovered alcoholic, believed in substance abuse treatment in a free-standing, non-hospital environment. In a brownstone on New York's Upper East Side, St. Luke's–Roosevelt Hospital established such a facility with Smithers's gifts which included an endowment. After he died, the Hospital decided to sell the facility and consolidate such treatment in the Hospital. When his widow complained,

⁴ Evelyn at 1183.

⁵ Evelyn at 1210-11 and 1212, discussing Smithers v. St. Luke's-Roosevelt Hosp. Ctr., 281 A.D.2d 127, 723 N.Y.S.2d 426 (1st Dep't App. Div. 2001); see The Things People Do When No One is Looking: An Argument for the Expansion of Standing in the Charitable Sector, 14 U. Miami Bus. L. Rev. 147 (2005); Donor Standing to Enforce Charitable Gifts: Civil Society v. Donor Empowerment, 58 Vand. L. Rev. 1093 (2005).

then New York Attorney General Vacco's Charities Bureau found that the Hospital had taken a very large sum from the Smithers' endowment. But after a political intervention, that Attorney General agreed with the Hospital to restore the sum taken, but without interest, and closed the investigation without dealing, among other things, with the Hospital's proposed sale of the free-standing recovery facility. The widow persuaded a court to appoint her as her late husband's special litigation executrix and sued. Attorney General Vacco defended successfully on the limited, but traditional, ground of no standing; only the attorney general can enforce charitable contributions.

At that point, Eliot Spitzer became Attorney General, and I became head of his Charities Bureau. I persuaded him to reverse our position on standing, and the Appellate Division, on a motion for a stay pending appeal, permitted the sale to go through but required the proceeds to be escrowed pending its decision on the merits. We began negotiating a settlement, and at oral argument on the merits, I asked the Appellate Division to return the case to the trial court for approval of the settlement. Instead, the court decided that Mrs. Smithers had standing.⁶ During oral argument Justice Ellerin, who wrote the majority opinion, asked me if it was true that the courts cannot always count on the attorney general to do the right thing, and I had to say, "Yes." Her opinion, explaining the court's decision, explicitly makes that point. Ultimately, the parties settled.

⁶ A similar decision, also discussed by Evelyn at 1183, is L.B. Research & Education Foundation v. UCLA Foundation, 29 Cal. Rptr.3d 710 (Cal. Ct. App. 2005), review denied, 2005 Cal. LEXIS 9658 (Cal. 2005); see Improving Enforcement Mechanisms in The Charitable Sector, 40 N. Eng. L.Rev. 447 (2006) (also discusses Smithers).

Given the spotty nature of state attorneys general interest in charities issues and the lack of resources even for those that are interested,⁷ Justice Ellerin was surely right. I hired 12 Charities Bureau lawyers in addition to the ten or so who were there when I arrived. Six Charities Bureau lawyers that I hired have left, and one long-serving lawyer has retired. It's not at all clear to me to what extent their positions will be filled by the new Attorney General who so far has not evidenced much interest in the Bureau's work.

3. Donor Advised Funds. How much do donors know about community foundations? For example, how many community foundations compensate their directors or trustees? How is it fixed? How many also have institutional trustees, investment managers and/or custodians, and how are they compensated? In how many cases are such institutions represented as directors, trustees or members or have the power to appoint or recommend directors, trustees or members?

Donor advised funds have been the subject of regulatory concern.⁸

The Pension Protection Act of 2006⁹ added to the Internal Revenue Code subchapter G of chapter 42, the two sections of which regulated certain donor advised fund distributions

⁷ See Marion R. Fremont-Smith, Governing Nonprofit Organizations c.6 (2001).

⁸ See Senate Finance Committee Staff Discussion Draft §A.2 (2004) and proposals from the philanthropic community, Independent Sector, Panel on the Nonprofit Sector, Strengthening Transparency Governance Accountability of Charitable Organizations, a final report to Congress and the Nonprofit Sector §III.6 (June 2005); cf. Brody Mullins, Government Steps Up Charity Crackdown – IRS Congress Aim to Curb Abuse of Popular But Unregulated Donor-Advised Funds, Wall Street Journal, June 22, 2005, at D1; Growing Assets and Concerns Proposed rules could hurt popularity of donor advised funds, Chronicle of Philanthropy, April 28, 2005, <http://www.philanthropy.com/premium/articles/v17/i14/14002401.htm>.

⁹ Pub. L. 109-280, 120 Stat. 780 (2006).

The changes are well discussed in John V. Woodhull, Major Changes for Donor-Advised Funds, <https://checkpoint.riag.com/app/servlet/com.tta.checkpoint.servlet.CPJSPervlet?usid=6b>.

and prohibited certain benefits. Section 1226 provided for a Treasury study on the organization and operation of such funds. It has yet to appear, even though the statute called for the report within a year, August 16, 2007, of enactment, and the Treasury requested comments on February 6, 2007.

Here are some more questions. Donors make a grant to a trustee that is a community foundation or to a community foundation itself in favor of a designated beneficiary, and the community foundation does not honor the designation. Who can enforce the grant? The donors, their legal representatives, their heirs, the beneficiary, anyone?

If donors make a grant to a trustee that is a community foundation or to a community foundation for general charitable purposes, do they or anyone else have any enforcement rights?

Have donors to community foundations or you here in the audience ever heard of the variance power? Are there any limitations on its use? If so, who can enforce them?

Many community foundations assert an apparently substantively unlimited, so-called “variance power”. By administrative action they assert they can change a donor’s restriction instead of getting the donor’s consent, if living, its successor, if any, or a court’s under either the Uniform Management of Institutional Funds Act,¹⁰ which has been enacted, one way or another, in all states and the District of Columbia except

¹⁰ http://www.nccusl.org/update/uniformact_summaries/uniformacts-s-umifa.asp (hereinafter “UMIFA”).

Alaska, Arizona and Pennsylvania, or in a *cy pres* or deviation proceeding. How clearly do donors understand this? How often is the variance power exercised? In whose favor is it exercised? Does the donor or successor or any regulatory official get prior notice? The Internal Revenue Service does not now require a report of any such exercise in the annual form 990. Should it?

Obviously, exercise of the variance power raises serious issues of consistency with donor intent.

Some of these questions were litigated in New York in Community Service Society v. New York Community Trust?¹¹ Many years before, Laura Spellman Rockefeller had established a fund in the New York Community Trust for three charities. Much later the Trust decided that one of those charities had changed its purposes and purported to exercise the variance power to change the beneficiary. Whether or not and when the beneficiary was notified was disputed. After a bench trial, an able New York County Surrogate held in an opinion that, alas, is not officially reported¹² that the Trust's exercise of the variance power was unwarranted and that, because of the lack of clarity surrounding notification, the statute of limitations did not preclude all the relief the charity sought. The immediate appellate court reversed on statute of limitations grounds, reaching far back into the record to find that the charity did have notice.

¹¹ 275 A.D.2d 171, 713 N.Y.S.2d 712 (1st Dep't App. Div. 2000), motions for leave to appeal denied or dismissed, 96 N.Y.2d 812, 751 N.E.2d 940 (N.Y. 2001).

¹² After I became head of the Charities Bureau I established a policy of encouraging judges to submit to official reporters non-profit decisions for publication. I was not in charge of the Charities Bureau at the time of the trial, although a Bureau lawyer "monitored" the trial. The Attorney General should have fully participated in this important trial.

Although the court did not reach the issue of in whose favor a variance power might be exercised and dismissed the action as time barred, it did quote and paraphrase with approval the thoughtful decision of the New York County Surrogate. It said that the variance power could only be exercised on a “showing that CSS [the plaintiff beneficiary] had diverted from its primary purpose.”¹³

The Surrogate’s conclusion, that exercise of the variance power should be limited to those situations where “identifiable negative details” may be offered to substantiate the “undesirability” of continued payments, appears to be an equitable and definable standard.¹⁴

....

Furthermore, the variance power must be broad enough to give undesirability a meaning independent of impossibility, impracticability or lack of necessity,” otherwise, the [Surrogate’s] court found, the variance power could be exercised in the most extreme circumstances nor, it opined, could the power be so broad as to permit a community foundation to ignore donors’ wishes without restraint.¹⁵

The Surrogate herself concluded:

otherwise would reduce the variance power to little more than a non-judicial cypres authority, exercisable only in the most extreme circumstances.

¹³ 275 A.D.2d at 182, 713 N.Y.S.2d at 719

¹⁴ Id. at 182-3, 720.

¹⁵ Id. at 178-79, 717.

. . . . There must be identifiable negative details to support the determination of undesirability . . . which would be likely to cause the donor to withdraw his support. . . .¹⁶

The decision has been criticized,¹⁷ yet the courts clearly were trying to prevent abuse of the variance power, and the above-cited article seems, to this writer, to be repetitive, long on polemic and short on principled analysis and to give short shrift to donor intent.

4. UMIFA, UPMIFA and Donor Intent. In concluding I want to alert donors to some particularly insidious provisions of the Uniform Prudent Management of Institutional Funds Act (UPMIFA)¹⁸ which last year the National Conference of Commissioners in Uniform State Laws recommended for enactment by the states as a replacement for UMIFA.

In general the UPMIFA purports to be more solicitous of donor intent than was UMIFA.¹⁹ However, like UMIFA, it does not apply to charitable trusts that are administered by non-charitable organization, e.g., banks and trust companies, and,

¹⁶ N.Y.L.J., Oct. 21, 1999, at 29, col. 6 (Surr. Ct. N.Y. County).

¹⁷ M. Sidel, Law, Philanthropy and Social Class: Variance Power and the Battle for American Giving, 36 U.C. Davis L. Rev. 1145 (2003).

¹⁸ http://www.law.upenn.edu/bll/archives/ulc/umoifa/2006final_act.htm (hereafter “UPMIFA”).

¹⁹ UPMIFA at 6 (under headings “Prudent Management and Investment” and “Donor Intent with Respect to Endowments”); §3(a) and sixth paragraph of the comment and the comment to subsection (a) thereto; §4(a) and first paragraph of the comment and the second paragraph of comment to subsection (a) thereto; second paragraph of the comment under the heading “Retroactive Application of the Rule of Construction”; §6(a) (“If the donor consents in a record, an institution may release or modify, in whole or in part, a restriction contained in a gift instrument. . . .”) and comment thereto.

therefore, but for one example, UPMIFA’s new “duty to minimize costs” does not apply to them.²⁰ The fees of for-profit trustees should be a concern to donors.²¹

Unlike UMIFA,²² however, UPMIFA does not clearly preserve resort to cy pres or deviation proceedings which ordinarily require notice to donors or their representatives,²³ but conflates them with a statutory procedure that requires notice only to the relevant attorney general.²⁴ We know how effective that may be.²⁵

Conclusion. Donors need in their gift instruments to reserve rights to notice of changes and to give specific instructions about spending. To the extent they have not been, but wish they had been, they should endeavor to renegotiate their gift instruments. Otherwise, UPMIFA, like UMIFA before it, may apply its “rules of construction” to negate casual endowment language.²⁶ In any case, donors should seriously consider opposing in their respective states UPMIFA’s abolition of notice to

²⁰ UPMIFA §3(c)(1).

“Charitable trusts not included in UPMIFA, primarily those managed by corporate trustees and individuals, will lose the benefits of UPMIFA’s endowment spending rule and the provisions permitting a charity to apply cy pres, without court supervision for modifications to a small old fund.” UPMIFA, comment to section 2, subsection 4.

²¹ Independent Sector Panel on the Nonprofit Sector, Strengthening Transparency Governance Accountability Charitable Organizations A Supplement to the Final Report to Congress and the Nonprofit Sector §2.3, at 13 (April 2006).

²² §7(d).

²³ E.g., N.Y. Estates, Powers & Trusts Law §8-1.1(c) (McKinney 2004).

²⁴ §6. The comment says:

Notice to Donors. The Drafting Committee decided not to require notification of donors under subsections (b), (c), and (d). The trust law rules of equitable deviation and cy pres do not acquire donor notification and instead depend on the court and the attorney general to protect donor intent and the public’s interest in charitable assets.

²⁵ See section 2 hereof and supra note 7.

²⁶ UPMIFA §§4(b) & (c) & 8 and comment to section 4 under heading “Retroactive Application of the Rule of Construction.”

donors and its application of rules of construction prospectively to pre-existing gift instruments. This is particularly the case for donors who think they have, or wish to create, true endowments.

Thank you.