

# **Avoiding Difficult Conversations with State Attorneys General**

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## **The Fundamentals of Charitable Gift Administration**

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## I. Introduction

Charitable gifts made to government entities and charitable organizations can be either restricted or unrestricted. An unrestricted charitable gift is a contribution of money or property that the donor makes without attaching any conditions on its use by the recipient entity or organization. The typical unrestricted charitable gift is the \$50 check sent to a favorite charity at the end of the calendar year or the \$20 bill dropped in the church collection plate on Sunday, both of which the donor intends will be used by the recipient organization as it sees fit in accomplishing its general charitable mission. An entity or organization in receipt of an unrestricted charitable gift is generally free to use that gift as it sees fit consistent with its general public or charitable mission.

A restricted charitable gift, in contrast, is a contribution of money or property that the donor makes to a government entity or charitable organization to be used for a specific charitable purpose and often according to carefully negotiated terms. Under state law, the recipient of a restricted charitable gift is obligated to administer the gift in accordance with the terms and purpose specified by the donor, and such terms and purpose are typically set forth in the instrument of conveyance. Restrictions on a gift may also arise, however, as a result of the solicitations of the charity.

Government entities and charitable organizations are required to administer restricted charitable gifts in accordance with the terms and purposes specified by the donors for a number of reasons: (i) individuals should have the right to dispose of their property as they wish, and charitable donors should not be forced to effectively disinherit their heirs in favor of charitable enterprises they didn't intend to support, and to which they might have objected; (ii) failing to honor the wishes of charitable donors would chill future charitable donations, which would be contrary to the public interest, (iii) honoring donor intent increases the diversity of projects and programs in the charitable sector, which is considered essential to a vigorous pluralistic society, (iv) government entities and charitable organizations will be subject to financial, political, and other pressures that may cause them to act in manners contrary to both donor intent and the public interest, and the laws governing the administration of charitable gifts provide a necessary check on decisions that may be made based on short-term expediencies and other pressures, and (v) even the most well-intentioned government and charity officials may not always know what is best or in the long term public interest, and what may seem like a reasonable change in charitable purpose today may turn out to have been a short-sighted mistake tomorrow, and this is particularly true with certain types of unique and irreplaceable assets, such as land, conservation easements, or artwork.

In almost all states, the state attorney general is empowered to supervise the administration of charities and charitable gifts within the state on behalf of the broader public, and to call government entities and nonprofits to account for breaching their fiduciary duties in failing to administer the charitable gifts they solicit and accept consistent with their terms and purposes.

In recent years, the Uniform Law Commission approved two uniform laws that make modest changes to existing common and statutory law applicable to the administration

of charitable gifts: the Uniform Prudent Management of Institutional Funds Act and the Uniform Trust Code. The changes were made, in part, to provide entities accepting charitable donations with somewhat greater flexibility to respond to changing conditions when administering restricted charitable gifts.

The staff and board of an entity soliciting or accepting charitable gifts should have an understanding of the basic state laws and doctrines that govern the administration of such gifts. These laws and doctrines are outlined in general below, but the law of a particular state must be consulted as each state's laws may vary in some of its particulars.

## II. Common Law Rules Governing Charitable Gifts

**A. Unrestricted Charitable Gifts.** An entity or organization in receipt of an unrestricted charitable gift is generally free to use that gift as it sees fit consistent with its general public or charitable mission. Some cautions regarding unrestricted gifts are noted below.

**(i) Solicitations.** An organization's communications while it is soliciting contributions may create legally binding restrictions that can be enforced under state laws. A written solicitation from a charity may constitute a "gift instrument" under the Uniform Prudent Management of Institutional Funds Act (UPMIFA). *See* Uniform Prudent Management of Institutional Funds Act § 2(3) cmt. (2006). The definition of "gift instrument" in UPMIFA includes written information that is stored in an electronic medium and is retrievable. Accordingly, solicitation materials posted on a website could create a donor-restriction if a donor responded to the solicitation with a gift. *Id.* A charity that fails to use gifts in accordance with its solicitation communications may also be subject to sanction under state and federal fraudulent solicitation laws.

**(ii) Unrestricted Gifts of Land.** Sometimes a donor may wish to make a gift of land to a land trust to be sold in the land trust's discretion (these types of gifts have sometimes been referred to as gifts of "trade lands"). A land trust should provide clear documentation to the donor of the land trust's intention to sell the property and use the proceeds for its general charitable mission *before* accepting the gift. *See* Standard 8, Practice L, *Land Trust Alliance Standards & Practices (revised 2004)*. A letter or other written document from the donor stating the donor's intent to grant the land trust such discretion would also be helpful in the event questions or concerns are raised when the land trust later sells or prepares to sell the land.

**(iii) Amending Bylaws to Change Purpose.** Even though a gift may be facially unrestricted, a donor who contributes money or assets to a charity likely assumes the charity will use the gift for the purposes for which the charity is operating at the time of the gift. Charities are, however, typically permitted under state law to amend their articles of incorporation or bylaws to modify their corporate purposes. Accordingly, a question may arise as to

whether a charity can apply unrestricted gifts received before a change in its corporate purpose to its new or expanded purpose. Some courts have held that unrestricted gifts are “impressed with a charitable trust” and must be used consistent with the charity’s purpose at the time the gift was made. *See, e.g., Holt v. College of Osteopathic Physicians and Surgeons*, 61 Cal. 2d 750 (1964); *Queen of Angels Hosp. v. Younger*, 66 Cal. App. 3d 359 (Ct. App. 1977). Other courts have similarly held, even though the unrestricted gifts were not deemed to technically be held in trust. *See, e.g., Attorney Gen. v. Hahnemann Hosp.*, 494 N.E. 2d 1011, 1020-21 (Mass. 1986) (the court noted: “As the Attorney General, colorfully, but no doubt correctly, observes in his reply brief, ‘those who give to a home for abandoned animals do not anticipate a future board amending the charity’s purpose to become research vivisectionists.’”).

**B. Restricted Charitable Gifts.** The recipient of a restricted charitable gift is legally bound to administer the gift in accordance with the terms and purpose specified by the donor. Regardless of how a restricted charitable gift is characterized under state law (as a restricted charitable gift, charitable trust, implied trust, quasi-trust, or otherwise), the substantive rules governing charitable trusts generally apply to the modification of the terms or purpose of the gift. *See, e.g., St. Joseph’s Hospital v. Bennett*, 22 N.E.2d 305, 306 (N.Y. 1939) (holding that, while no trust arose in a technical sense, a charitable corporation “may not . . . receive a gift made for one purpose and use it for another, unless the court applying the *cy pres* doctrine so commands”). These rules are summarized below.

**(i) Express Powers.** Express powers are discretionary powers granted to a donee government entity or charitable organization by the terms of a charitable gift. Courts do not interfere with a donee’s exercise of express powers unless the donee has clearly abused its discretion. *See, e.g., RESTATEMENT (THIRD) OF TRUSTS* § 87 (2003).

**(ii) Implied Powers.** Donees of charitable gifts may also be deemed to have certain “implied powers” to do what is “necessary or appropriate” to carry out the purposes of a gift and not forbidden by the terms of the gift. GEORGE G. BOGERT ET AL., *THE LAW OF TRUST AND TRUSTEES* § 551 (WEST 2008). Courts traditionally have, however, been reluctant to find that donees have powers not expressly granted to them. Accordingly, it is customary in well-drafted gift instruments to include provisions expressly conferring upon the donee all powers that are or may become necessary or appropriate for the efficient administration of the gift.

**(iii) Doctrines of Administrative Deviation and *Cy Pres*.** The doctrine of administrative (or equitable) deviation and the doctrine of *cy pres* are distinct. The doctrine of administrative deviation applies to the modification of an administrative term (but not the purpose) of a gift, and is sometimes described as permitting a court to modify the means by which the purpose is to be accomplished. The doctrine of *cy pres*, on the other hand, applies to the modification of the charitable purpose of a gift.

Courts have traditionally been more willing to permit donees to deviate from the administrative terms (as opposed to the charitable purpose) of a gift. This is presumably because courts recognize that charitable donors are less likely to be wedded to the administrative terms of their gifts, particularly if altering administrative terms will better accomplish the donor's overall charitable purpose. In other words, courts presumably recognize that altering the administrative terms of a gift is less likely to do violence to the donor's intent and chill future charitable donations.

**a) Administrative Deviation.** Pursuant to the traditional formulation of the doctrine of administrative deviation, a court could authorize a donee to deviate from an administrative term of a gift only if, owing to circumstances not known to the donor and not anticipated by him, compliance with the term would defeat or substantially impair the accomplishment of the purposes of the gift. The modern tendency, however, has been to permit a donee to deviate from an administrative term in situations where continued compliance with the term is deemed to be undesirable, inexpedient, or inappropriate, and regardless of whether the donor had foreseen the circumstances.

*In re Pulitzer*, 249 N.Y.S. 87 (N.Y. Surr. Ct. 1931), aff'd mem., 260 N.Y.S. 975 (N.Y. App. Div. 1932), is a classic example of the application of the doctrine of administrative deviation. Mr. Pulitzer created a trust for the benefit of his descendants, funded it with stock in a corporation that published a newspaper to which he had devoted his life, and expressly forbade the trustees from selling the stock. When the newspaper later became unprofitable and the prohibition on the sale of the stock threatened the trust corpus, the trustees sought and received judicial approval to sell the stock. In approving the deviation from the "no sale of stock" administrative term, the court explained "[t]he dominant purpose of Mr. Pulitzer must have been the maintenance of a fair income for his children and the ultimate reception of the unimpaired corpus by the remaindermen." *Id.* at 94.

**b) Cy Pres.** Under the traditional formulation of the doctrine of *cy pres*, if (i) the charitable purpose of a gift becomes illegal, impossible, or impracticable, and (ii) the donor is determined to have had a general intent to devote the donated assets to charitable purposes (a "general charitable intent"), then (iii) a court can formulate a substitute plan for the use of the assets (or the proceeds from their sale) for a charitable purpose that is as near as possible to the purpose specified by the donor.

Courts almost invariably find that a donor had a general charitable intent—and apply *cy pres*—if the purpose of a gift becomes

impossible or impracticable after the passage of some period of time. There are two reasons for this: (i) applying *cy pres* and authorizing the use of the donated assets for a charitable purpose that is as near as possible to that specified by the donor is more likely to fulfill the donor's intent than to have the gift fail altogether and the assets pass to the donor's residuary beneficiaries or intestate heirs and (ii) identifying and locating a donor's remote beneficiaries or heirs after the passage of time would often entail considerable difficulty and expense.

*Jackson v. Phillips*, 96 Mass. 539 (1867), is perhaps the most famous example of the application of the doctrine of *cy pres*. *Jackson v. Phillips* involved a charitable trust created to promote the abolition of slavery. When the purpose of the trust became "impossible or impracticable" as a result of the adoption of the Thirteenth Amendment to the Constitution, the court applied the doctrine of *cy pres* and instructed the trustees to use the assets to aid former slaves and assist necessitous persons of African descent.

*Cohen v. City of Lynn*, 598 N.E.2d 682 (1992), illustrates that status as a restricted charitable gift and the high threshold standard for the doctrine of *cy pres* can operate to protect against the disposal of a charitable gift contrary to donor intent and the public interest. *Cohen v. City of Lynn* involved a parcel of land that had been conveyed to the City of Lynn in 1893 pursuant to deeds stating that the land was to be used "forever for park purposes." The City later attempted to sell the land to a private developer to be used as a parking lot. The trial court judge found that the parcel possessed "a beautiful scenic ocean view" and was "suitable for park purposes." He also found that the parcel "was a popular area for walkers, riders, and joggers" and "provided a scenic vista of open space suitable for park purposes and reinforced the 'greenness' of the area." The Appeals Court of Massachusetts held that (i) the sale violated the City's obligation under a public charitable trust, (ii) acceptance of the deeds by the City created a contract between the donors and the City that could not be altered through state legislation purportedly authorizing the sale, and (iii) because the City and the developer were unable to demonstrate that it had become impossible or impracticable to carry out the original park purpose, the doctrine of *cy pres* could not be applied to permit the sale.

**C. Standing to Sue.** A donee's failure to administer a restricted charitable gift consistent with its terms or purpose constitutes a breach of the donee's fiduciary duties to both the donor and beneficiaries of the gift. Standing to sue a donee for such a breach has traditionally been limited to:

- (i) the state attorney general,

- (ii) a co-trustee or co-director, and
- (iii) parties with “special interest” in the enforcement of the gift.

*See* RESTATEMENT (SECOND) OF TRUSTS § 391.

The donor of a restricted charitable gift traditionally has not had standing to sue to enforce the gift. Instead, donors have been forced to appeal to the state attorney general to file suit if the donee of a restricted charitable gift breaches its fiduciary duties and uses or threatens to use the gift contrary to its terms or purpose. Due to lax attorney general oversight of charities as well as courts’ traditional reluctance to grant parties with a “special interest” standing to sue holders of charitable gifts when they threaten or use restricted charitable gifts contrary to their terms or purposes, a few courts have been willing to grant standing to donors or their representatives. *See, e.g., Smithers v. St. Luke’s-Roosevelt Hospital Center*, 281 A.D.2d 127 (2001) (holding that the executrix of the estate of the donor of a charitable gift had standing to sue the donee to enforce the terms of the gift after the state attorney general entered into a compromise agreement with the donee that was contrary to the terms of the gift). *But see Hardt v. Vitae Foundation, Inc.*, 302 S.W.3d 133 (Mo. App. W.D. 2009), discussed below.

Donors of charitable gifts may have the right to, in the gift instrument, reserve to themselves or grant to others the express right to sue the donee for a breach of its fiduciary duties. *See, e.g., Rettek v. Ellis Hospital*, 2009 U.S. Dist. LEXIS 1607 (2009) (declining to grant “special interest” standing to a charitable donor’s niece based solely on her familial relation to the donor, but noting that “donors can ensure their wishes are honored by expressly providing for enforcement by family members or forfeiture if their restrictions are not satisfied”).

States also generally recognize the right of the attorney general to authorize a third party (known as a “relator”) to bring a suit to redress a breach of trust in the place of the attorney general, subject to the attorney general’s oversight and control, but this right is rarely invoked.

### **III. NCCUSL’s Oversight of Charitable Assets Act Project**

The National Conference of Commissioners on Uniform State Laws (NCCUSL) has appointed a Drafting Committee that is in the process of drafting an Oversight of Charitable Assets Act (Act). One of the major goals of the Act is to articulate state Attorney Generals’ oversight authority to protect charitable assets, including the Attorney General’s role in protecting the expressed intent of charitable donors. Among other things, the present draft of the Act specifies the Attorney General’s investigatory powers and the obligation of charities to register in a state and provide notifications to the attorney general.

The Drafting Committee has been working on the Act for well over a year. NCCUSL solicits the views and comments of those with knowledge in the field. Having received input and instructions at NCCUSL’s Annual Meeting this past summer, the Drafting Committee will meet at least two more times, with a probable final reading and action by the full conference

at NCCUSL's Annual Meeting in the summer of 2011. The Chairman of the Drafting Committee is K. King Burnett, a practicing attorney from Maryland. Co-Reporters are Laura Brown Chisolm of Case Western Reserve University, Cleveland, Ohio, and Susan N. Gary of the University of Oregon.

The current draft of the Act and related materials are available at [www.nccusl.org](http://www.nccusl.org), at NCCUSL Committees; Drafting Committees.

#### **IV. Uniform Prudent Management of Institutional Funds Act (UPMIFA)**

According to UPMIFA's website, the Act has been enacted in 48 states and the District of Columbia.<sup>1</sup> As the prefatory note to the Act states: "UPMIFA provides guidance and authority to charitable organizations concerning the management of funds...modernizes the rules governing expenditures from endowment funds...[and] updates the provisions governing the release and modification of restrictions on charitable funds..."

The Act generally applies to the funds charities hold for charitable purposes. It emphasizes fidelity to donor intent – and includes charitable solicitation as a source for determining donor intent. Among the duties owed under UPMIFA by people who manage charitable funds are the duties of loyalty, care, and good faith. The Act also requires that managers pay attention to investment costs, and sets forth a fairly broad set of factors for managers to consider as investment decisions are made, including economic conditions, total return, the profile of the portfolio, and the short and long term interests of the charity.

UPMIFA allows managers to determine what part of an endowment may be appropriated for expenditure, but prescribes consideration of a similarly broad set of factors, and establishes seven percent of the three year average market value as a level of expenditure that creates a rebuttable presumption of imprudent management.

It is important for donors and non-profit managers to note that under UPMIFA standards, a donor restriction specifying "income only" or the like will not be interpreted as an instruction not to consider total return unless the donor is particularly clear that, for example, "while this dividends-only restrictions may affect investment decisions and be influenced by a variety of factors that are difficult to predict, it is my wish that 'dividends-only' *not* be interpreted to permit consideration of the total return..." or some such especially prescriptive language. A donor may, however, specify a particular percentage of the fund to be annually expended.

Finally, UPMIFA permits releases and modifications of donor restrictions on fund management or purpose that the common law would not have allowed. If the donor consents in writing, a charity may release or modify, in whole or in part, a restriction contained in a gift instrument on the management, investment, or purpose of a fund, though the gift must still serve a charitable purpose. In a special nod to the expense of maintaining

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<sup>1</sup> See Uniform Prudent Management of Institutional Funds Act, Enactment Status, at <http://www.upmifa.org/DesktopDefault.aspx?tabindex=5&tabid=68> (the two remaining states are Mississippi and Pennsylvania). UPMIFA and related materials and information are available at <http://www.upmifa.org/DesktopDefault.aspx?tabindex=0&tabid=74> and [www.nccusl.org](http://www.nccusl.org).

small funds that are accompanied by restrictions, UPMIFA permits a charity to modify management or purpose restrictions on funds of less value than a legislatively prescribed amount – \$25,000 is suggested – more liberally than the common law would have allowed: without court participation, upon notice to the Attorney General, and if twenty years have passed since the fund was established.

Modification by a court of a fund management provision is also allowed, with notice to the Attorney General, if a restriction on management of a fund is impracticable or wasteful, or if, because of changed circumstances, modification of management restrictions would better serve the purposes of the fund. The fund’s purposes themselves can also be modified by a court upon the application of a charity and notice to the Attorney General. UPMIFA directs the court to apply the familiar common law *cy pres* standards to such an application.

**A. Standing to Sue.** UPMIFA, in structure, and (at least with respect to modifications of restrictions) in its Prefatory Note, assumes that a state’s Attorney General will be the usual entity with standing to enforce the provisions of the Act. Directors of a charity may also seek judicial intervention if they are persuaded that there has been a breach of the required duties binding those who manage the charity’s funds.

In a 2009 case, *Hardt v Vitae Foundation, Inc.*, 2009 Mo. App. LEXIS 1567, a Missouri appeals court affirmed a trial court judgment dismissing a lawsuit brought by a donor who appears to have alleged a fair grievance against a charity that ignored restrictions and agreements with respect to the use of a gift of funds. The court, having taken note that none of the parties contended that the gift created a charitable trust, directed the donor to the state’s Attorney General as the means to seek resolution of the grievance. The court pointed out that donors were not granted standing to enforce their own charitable restrictions at common law, and noted that UPMIFA could have, but did not change that common law rule. A donor otherwise discouraged by the decision might take heart in the court’s hedge: “[w]hile it is conceivable that there may be times when the Attorney General does not sufficiently represent a donor’s interest, it has not been shown to be the case here....”

Charities involved in a donor dispute regarding institutional fund management should not feel secure if their best defense is lack of standing. Parties with a “special interest” in the enforcement of a charitable gift have standing to sue under the common law, although that term is generally construed narrowly by the courts. In addition, faced with egregious breaches of trust that would otherwise go unremedied, courts have on occasion been known to grant standing to donors.

**B. Permanently, Temporarily, and Board Restricted Funds.** UPMIFA fund management standards apply to all “fund[s] held by an institution exclusively for charitable purposes.” Special UPMIFA rules apply to endowments, as discussed above, and the Act specifies that “the assets in an endowment fund” established by a donor “are donor-restricted assets,” thus doing away with previous historic value standards. But the Act does not generally concern itself with the classification of funds under Generally Accepted Accounting Principles (GAAP). While GAAP rules

do not bind a court in considering whether restrictions apply for charitable gift administration purposes, GAAP rules do govern the preparation of a charity's financial statements. Specifically, GAAP rules require that a charity distinguish between assets that are restricted and unrestricted, and, further, that among restricted assets, permanently restricted assets be distinguished, for accounting purposes, from temporarily restricted assets.

A common kind of temporarily restricted gift for a land trust would be a gift toward the acquisition of a specific parcel of property for which, for example, a purchase option had been secured.

Land trusts are most likely to see permanently restricted assets in the form of gifts for stewardship endowments relating to their management of specific properties or specific conservation easements. Note, however, that a Board policy that calls for allocating all or part of a specific category of gifts to endowment does not result in a restricted asset unless that policy is a prominent part of a gift solicitation.

Restrictions for GAAP purposes must be clearly imposed by the donor, or otherwise prominent in the documents and circumstances surrounding a gift.

## V. Uniform Trust Code (UTC)

The UTC is the first national codification of the law of trusts. *See* Uniform Trust Code (2000, last revised or amended in 2005), available at [www.nccusl.org](http://www.nccusl.org). The UTC is intended to provide States with precise, comprehensive, and easily accessible guidance on trust law questions. Much of the UTC is a codification of the common law of trusts. The UTC does, however, contain a number of innovative provisions, including rules on trust modification and termination that are intended to enhance flexibility consistent with the principle that preserving the settlor's intent is paramount, as well as a grant of standing to the settlor of a charitable trust to sue to enforce the trust.

The UTC is relevant to the administration of restricted charitable gifts because courts generally apply trust law principles to the administration of such gifts. *See* UTC § 413 cmt. (“The doctrine of *cy pres* is applied not only to trusts, but also to other types of charitable dispositions, including those to charitable corporations ... in formulating rules for such dispositions, the courts often refer to the principles governing charitable trusts, which would include this Code”).

The UTC has been adopted by twenty-two states and the District of Columbia.<sup>2</sup> States sometimes modify provisions of the UTC upon adoption, so readers are advised to refer to the version of the UTC adopted in the relevant state.

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<sup>2</sup> The adopting states are Alabama, Arizona, Arkansas, Florida, Kansas, Maine, Missouri, Michigan, Nebraska, New Hampshire, New Mexico, North Carolina, North Dakota, Ohio, Oregon, Pennsylvania, South Carolina, Tennessee, Utah, Vermont, Virginia, Wyoming. *See* [http://www.nccusl.org/nccusl/uniformacts\\_factsheets/uniformacts-fs-utc2000.asp](http://www.nccusl.org/nccusl/uniformacts_factsheets/uniformacts-fs-utc2000.asp).

## A. Changes made by the UTC to the Common Law

**(i) Administrative Deviation.** Under the UTC, the standard for administrative deviation is somewhat liberalized while not being unbridled. UTC § 412(a) provides that a court may modify the administrative or dispositive terms of a trust if, because of circumstances not anticipated by the settlor, modification will further the purposes of the trust. The comments to the UTC explain that the purpose of this provision “is not to disregard the settlor’s intent but to modify inopportune details to effectuate better the settlor’s broader purposes.” UTC § 412 cmt.

UTC § 412(b) provides that a 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. The comments to the UTC explain that this provision “broadens the court’s ability to modify the administrative terms of a trust” and “is an application of the requirement . . . that a trust and its terms must be for the benefit of its beneficiaries.” UTC § 412 cmt. The comments further explain that, “[a]lthough 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.” *Id.*

**(ii) *Cy Pres.*** UTC § 413(a) codifies and at the same time modifies the doctrine of *cy pres*, at least as applied in most states. It specifically provides that, if a particular charitable purpose becomes unlawful, impracticable, impossible to achieve, or wasteful: (1) the trust does not fail, in whole or in part, (2) the trust property does not revert to the settlor or the settlor’s successors in interest, and (3) the court may apply *cy pres* to modify or terminate the trust by directing that the trust property be applied or distributed, in whole or in part, in a manner consistent with the settlor’s charitable purposes.

- UTC § 413(a) thus authorizes the court to apply *cy pres* not only if the settlor’s purpose becomes illegal, impossible, or impractical, but also if such purpose becomes wasteful. The wasteful standard was added to the UTC primarily to deal with the problem of surplus funds. *See* David M. English, *The Uniform Trust Code (2000): Significant Provisions and Policy Issues*, 67 Mo. L. Rev. 143, 179 n.164 (2002) (“Cases of waste normally involve situations where the funds allocated to the particular charitable scheme far exceed what is needed.”).
- UTC § 413(a) also modifies the doctrine of *cy pres* by presuming that the settlor had a general charitable intent. Thus, under § 413(a), if the particular purpose for which a trust was created becomes impracticable, unlawful, impossible to achieve, or wasteful, the donor will be presumed to have had a general charitable intent, the trust will not fail, and the assets will not pass to the donor’s residuary

beneficiaries or intestate heirs. Rather, the court must direct that the trust property be applied or distributed in a manner consistent with the settlor's charitable purpose.

Responding to concerns about the clogging of title and other administrative problems caused by remote default provisions upon failure of a charitable purpose, UTC § 413(b) invalidates a "gift over" to a noncharitable beneficiary upon failure of the settlor's charitable purpose unless the trust property is to revert to the living settlor or fewer than twenty-one years have elapsed since the trust's creation. Thus, even if the trust instrument provides for the reversion of the trust assets to the settlor or the settlor's heirs in the event the settlor's designated charitable purpose becomes impossible or impracticable, such provision will not be effective unless, at the time the settlor's designated purpose becomes impossible or impracticable, either the settlor is alive or fewer than twenty-one years have passed since the trust's creation. If the settlor is no longer alive and more than twenty-one years have elapsed, the court must apply *cy pres* and direct that the trust property be applied or distributed in a manner consistent with the settlor's charitable purpose.

**(iii) Uneconomic Trusts.** UTC § 414(a) allows a trustee, after notice to the qualified beneficiaries, to terminate a trust consisting of trust property having a total value less than [\$50,000] if the trustee concludes that the value of the trust property is insufficient to justify the cost of administration. The comments to UTC § 414 explain that the drafters assumed a trust with a value of \$50,000 or less is likely to be inefficient to administer, thereby justifying a statutory grant to the trustee of the power to terminate the trust without court approval. The \$50,000 amount is placed in brackets in the UTC to signal to enacting jurisdictions that they may wish to designate a higher or lower figure. UTC § 414(a) is also a default rule, meaning that a settlor is free to set a higher or lower figure, specify different termination procedures, or prohibit termination without a court order. Upon the termination of a trust pursuant to UTC § 414(a), the trustee must distribute the trust property in a manner consistent with the purposes of the trust. *See* UTC § 414(c).

UTC § 414(d) specifically provides that the rules permitting a trustee to terminate an uneconomic trust do not apply to conservation easements. In the comments to UTC § 414, the drafters explained:

Even though not accompanied by the usual trappings of a trust, the creation and transfer of an easement for conservation or preservation will frequently create a charitable trust. The organization to whom the easement was conveyed will be deemed to be acting as trustee of what will ostensibly appear to be a contractual or property arrangement. Because of the fiduciary obligation imposed, the termination or substantial modification of the easement by the "trustee" could constitute a breach of trust. The drafters of the

Uniform Trust Code concluded that easements for conservation or preservation are sufficiently different from the typical cash and securities found in small trusts that they should be excluded from this section, and subsection (d) so provides. Most creators of such easements, it was surmised, would prefer that the easement be continued unchanged even if the easement, and hence the trust, has a relatively low market value. For the law of conservation easements, see RESTATEMENT (THIRD) OF PROPERTY: SERVITUDES §1.6 (2000).

**(iv) Combination and Division of Trusts.** UTC § 417 allows a trustee, after notice to the qualified beneficiaries, to combine two or more trusts into a single trust or divide a trust into two or more separate trusts if the result does not impair rights of any beneficiary or adversely affect achievement of the purposes of the trust. The comments to UTC § 417 explain that, while that section does not require that a court or the beneficiaries approve a combination or division, prudence may dictate that such approval be obtained whenever the terms of the trusts to be combined or the trusts that will result from a division differ substantially one from the other.

**(v) Standing to Sue.** UTC § 405 grants standing to the settlor of a charitable trust to maintain a proceeding to enforce the trust. The comments clarify that this grant of standing to the settlor of a charitable trust does not negate the right of the state attorney general, a co-trustee, or a party with a “special interest” to enforce the trust. *See* UTC §§ 405 cmt., 413 cmt. *Cf. Hardt v. Vitae Foundation, Inc.*, 302 S.W.3d 133 (Mo. App. W.D. 2009) (declining to apply the UTC’s settlor standing rule to the donor of a restricted charitable gift governed by UPMIFA because UPMIFA does not similarly grant donors standing).

## VI. Protections Afforded to Restricted Charitable Gifts

**A. Particularly Favored by the Courts.** Charitable gifts are particularly favored by the courts and courts go to the length of their equitable powers to sustain such gifts. *See, e.g., Harris v. Georgia Military Acad.*, 146 S.E.2d 913, 915 (Ga. 1966) (“Gifts or trusts for charitable purposes are favorites of the law and the courts . . . [and] courts of equity, it is said, will go to the length of their judicial power to sustain such gifts.”); *Webb v. Webb*, 172 N.E. 730, 735 (Ill. 1930) (“Gifts to charity have always been looked upon with favor by the courts. Every presumption consistent with the language used will be indulged to sustain them.”); *In re Estate of Homburg*, 697 So. 2d 1154, 1158 (Miss. 1997) (“[C]haritable trusts are favored and should be enforced where possible.”); *Board of Trustees of Univ. of N. C. v. Unknown Heirs*, 319 S.E.2d 239, 242 (N.C. 1984) (“It is a well recognized principle that gifts and trusts for charities are highly favored by the courts. Thus, the donor’s intentions are effectuated by the most liberal rules of construction permitted.”); *Bentley v. Whitney*, 281 P. 188, 190 (Wyo. 1929) (“The provisions of instruments creating charitable trusts are favorably regarded by the courts and are generally construed with the utmost liberality in order to carry out the laudable purpose of the donor.”). Thus, for example, in the case of a conservation easement donated as a charitable gift, courts should construe the terms

of the easement liberally in favor of carrying out the donor's charitable conservation purpose rather than in favor of the free use of land.

**B. Protections in Bankruptcy.** In some cases, restricted donations or trust assets of a non-profit corporation debtor may be excluded from the bankruptcy estate. See Ronald J. Sommers et. al. *Non-profit Corporations in Bankruptcy: Navigating the Automatic Stay, Excluding Assets from the Bankruptcy Estate, Applying the 2005 Bankruptcy Code Amendments* (National Association of State Charity Officials, Austin, Texas, Oct. 19, 2009). State law determines whether restricted donations or property held in trust are property of the estate. *Id.* Restricted donations are donations of money or other property that must be used for a particular purpose, such as building a specified facility or providing specified free services to the public, and are not available to cover operating expenses or other activities of the non-profit corporation. *Id.* The Bankruptcy Court for the Western District of Texas found that restricted donations were not property of the estate and therefore were not available for distribution to the general creditors in *In re Save Our Springs (S.O.S.) Alliance, Inc.*, 388 B.R. 202, 247 (Bankr. W.D. Tex. 2008). *Id.*

Nonprofits should request that their donors seek the advice of counsel who can draft appropriate restrictions to be included in the relevant gift instrument. So long as the restrictions are well written and binding under relevant state law, a bankruptcy court will likely uphold them, forbidding the trustee from using such funds to pay creditors. See Jack A. Eiferman & J. Patrick Yerby, *Nonprofits in Trouble: Receiverships and Bankruptcy* 22-16 (3rd Edition, 1st Supplement 2008).

**C. Constitutional Limits on Legislative Changes.** Numerous courts have held that a state legislature cannot interfere with charitable gifts or charitable trusts by either changing the method of control or administration of such gifts or trusts or providing that the gift or trust property shall be devoted to purposes other than those designated by the donors. Some decisions are based on the states' inability to impair contracts made between charitable donors and their donees. Other decisions are based on the doctrine of separation of powers and the judiciary's jurisdiction over the administration of charitable assets. See, e.g., *Kapiolani Park Pres. Soc'y v. Honolulu*, 751 P.2d 1022, 1026-28 (Haw. 1988) (ruling that if legislation had the effect of granting the city the power to lease a portion of parkland held in a charitable trust in derogation of the express terms of the trust it would have been beyond the legislature's power and unconstitutional pursuant to Article I, Section 10 of the Constitution of the United States and it would also "violate[] the basic principles of equity" and, "in effect, defraud the donors"); *Opinion of the Justices*, 371 N.E.2d 1349, 1355 (Mass. 1978) ("[a]lthough the Legislature does possess some authority to alter charitable trusts, this authority is narrowly limited . . . [i]t is not within the power of the Legislature to terminate a charitable trust, to change its administration on grounds of expediency, or to seek to control its disposition under the doctrine of *pres.*").

## VII. Resources.

**A. Uniform Laws.** UMIFA, UPMIFA and the UTC, including the comments thereto, are available at [www.nccusl.org](http://www.nccusl.org).

**B. Restatement (Third) of Trusts.** The Restatement (Third) of Trusts continues the approach of the Restatement (Second) of Trusts that a restricted gift to a corporate charity creates a trust. Section 28 of the Restatement (Third) of Trusts provides:

An outright devise or donation to a ... charitable institution, expressly or impliedly to be used for its general purposes, is charitable but does not create a trust .... A disposition to such an institution for a specific purpose, however, such as to support medical research, perhaps on a particular disease, or to establish a scholarship fund in a certain field of study, creates a charitable trust of which the institution is the trustee ....

**C. Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations (Reference Edition).** *Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations* was released by the Panel on the Nonprofit Sector in October 2007. The Guide outlines thirty-three Principles designed to support board members and staff leaders of every charitable organization as they work to improve their operations. The Reference Edition includes legal background for each Principle and is available at <http://www.nonprofitpanel.org/Report/index.html>.

Principle 28 provides “*Contributions must be used for purposes consistent with the donor’s intent, whether as described in the relevant solicitation materials or as specifically directed by the donor.*” The Reference Edition explains the legal background to this Principle as follows:

If a donor provides a clear, written directive about how funds are to be used at the time a charitable gift is made, the board of the recipient organization has a fiduciary obligation to comply with the donor’s directive and state attorneys general may enforce compliance. In some states, the donor (or his or her heirs) may have legal standing to ask a court to enforce those terms. This type of instruction would include a contract or grant agreement between a private or public funder and a charitable organization. An organization’s communications while it is soliciting contributions may also create a legally binding restriction that can be enforced under state and federal fraudulent solicitation prohibitions.

When carrying out a donor’s clear, written directive on how to use a contribution becomes impossible, impracticable, or illegal, a charitable organization or the state Attorney General may appeal to a court for authority to alter the original purposes of the gift or deviate from directions provided by the donor.

**D. The Donor Bill of Rights.** The Donor Bill of Rights was created by the Association of Fundraising Professionals, the Association for Healthcare Philanthropy, the Council for Advancement and Support of Education, and the Giving Institute: Leading Consultants to Non-Profits. The Donor Bill of Rights provides in relevant part:

Philanthropy is based on voluntary action for the common good. It is a tradition of giving and sharing that is primary to the quality of life. To ensure that philanthropy merits the respect and trust of the general public, and that donors and prospective donors can have full confidence in the nonprofit organizations and causes they are asked to support, we declare that all donors have these rights:

I. To be informed of the organization's mission, of the way the organization intends to use donated resources, and of its capacity to use donations effectively for their intended purposes.

. . .

IV. To be assured their gifts will be used for the purposes for which they were given.

The Donor Bill of Rights is available at <http://www.afpnet.org/Ethics/EnforcementDetail.cfm?itemnumber=3359>.