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Allocating State Authority Over Charitable Nonprofit Organizations

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ABSTRACT

This Essay considers the allocation of state authority to enforce the legal obligations particular to charities and their leaders among state officials, including attorneys general, judges, and legislators, and private parties. It first describes the existing allocation. It then reviews the most common criticisms of this allocation, which primarily focus on two concerns: politicization and lack of sufficient enforcement. Finally, it evaluates the most notable proposals for re-allocating this authority, including reallocation of this authority in part to private parties.

This Essay conclude that reform proposals have two fundamental flaws. First, proposals aimed at countering the political nature of state attorney general decisions fail to consider both the advantages of that nature and the existing restraints placed on it by state courts and resource limitations. Second, proposals aimed at addressing the admittedly low level of oversight provided by state attorneys general assume that there is significant undiscovered malfeasance at charities, the countering of which would justify the burdens these proposals would place on all charities, even though empirical data supporting this assumption are lacking.

That said, this Essay supports more modest reforms. These are: requiring all attorney general negotiated settlements to be submitted to state courts for approval; permitting derivative suits by current fiduciaries, as is the law in most states, and by a significant proportion of members, as is the law in some states; and modestly expanding donor standing to allow substantial donors (but not their successors or heirs) to enforce explicit written terms on substantial gifts. These reforms would strengthen existing state oversight while being unlikely to significantly burden most charities.

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I am very grateful for comments from Mary Beckman and other attendees at the UCLA Law Symposium on The Restatement of the Law, Charitable Nonprofit Organizations.

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INTRODUCTION

As the Restatement of the Law, Charitable Nonprofit Organizations (the Restatement) details, authority to enforce the legal obligations particular to charities and their leaders is allocated among state officials, federal tax officials, and private parties.[1] The broadest authority rests with state officials, specifically attorneys general and judges, who collectively have the legal authority to protect the assets and interests of charities within their relevant jurisdictions and to enforce fiduciary duties.[2] Commentators have criticized the excise of this authority by state officials primarily on two grounds—politicization and lack of sufficient enforcement—and proposed various reforms to address these criticisms, including reallocation of this authority in part to private parties.[3]

This Essay briefly describes the existing allocation of this state enforcement authority among attorneys general, judges, legislators, and private parties. It then reviews the most common criticisms of this allocation and evaluates the most notable proposals for reallocating this authority. Given the breadth of state authority over charities, the growing importance of state oversight as Internal Revenue Service oversight diminishes, and space considerations, this Essay will not consider the role of federal and state tax officials, state oversight of charitable solicitation, or self-regulation by charities.[4] In this context, self-regulation refers to "situations in which one organization (other than a government) sets standards for, oversees, accredits, or regulates other organizations," as opposed to an organization setting standards for itself.[5]

1. RESTATEMENT OF CHARITABLE NONPROFIT ORGANIZATIONS §§ 5.01 to 6.05 (AM. L. INST. 2021) [hereinafter RESTATEMENT].
2. *Id.* §§ 5.01(a) & cmt. a, 5.02(a), (b)(8).
3. *See infra* Parts II, III.
4. *See generally* RESTATEMENT, *supra* note 1, §§ 4.05 (charitable solicitation), 5.03 (federal tax officials). For recent consideration of the relationship between federal tax and state oversight, *see, e.g.*, Eric Franklin Amarante, *States as Laboratories for Charitable Compliance: An Empirical Study*, 90 GEO. WASH. L. REV. 445 (2022); Jaclyn Fabean Cherry, *Nonprofit Governance: Who Should Be Watching?*, 13 OHIO ST. BUS. L.J. 153 (2019); Lloyd Hitoshi Mayer, *Fragmented Oversight of Nonprofits in the United States: Does It Work? Can It Work?*, 91 CHI.-KENT L. REV. 937 (2016).
5. STUDIES ON MODELS OF SELF-REGULATION IN THE NONPROFIT SECTOR (2005), at 2, http://ncpl.law.nyu.edu/wp-content/uploads/pdfs/Self%20Regulation%20Final%20Report-040307updates.pdf [https://perma.cc/T4SB-QYCA]. The oversight organization may be voluntary in that nonprofits choose whether to submit themselves to the organization's oversight; the Evangelical Council for Financial Accountability is an example of such an entity. *See* ECFA, FAQS—HOW DOES ECFA ACCREDITATION AND MEMBER ACCOUNTABILITY WORK, https://www.ecfa.org/Content/FAQs-How-Does-ECFA-

I conclude that reform proposals have two fundamental flaws. First, proposals aimed at countering the political nature of state attorney general decisions fail to consider both the advantages of that political nature and the existing restraints placed on it by state courts and resource limitations. Second, proposals aimed at addressing the admittedly low level of oversight provided by state attorneys general assume that there is significant undiscovered malfeasance at charities, the countering of which would justify the burdens these proposals would place on all charities, even though empirical data supporting this assumption are lacking. That said, I support requiring the submission of all attorney general negotiated settlements to state courts for approval; permitting derivative suits by current fiduciaries, as is the law in most states and by a significant proportion of members, as is the law in some states; and modestly expanding donor standing to allow substantial donors–but not their successors or heirs–to enforce explicit written terms on substantial gifts. As detailed below, these reforms strengthen existing state oversight while being unlikely to significantly burden most charities.

I. EXISTING ALLOCATION OF AUTHORITY AMONG STATE ATTORNEYS GENERAL, STATE JUDGES, STATE LEGISLATORS & PRIVATE PARTIES

The allocation of authority over charities among state officials and private parties varies across the 50 states and the District of Columbia. Yet as the Restatement documents, the allocation among attorneys general, judges, and legislators is relatively uniform.[6] In contrast, the extent to which private parties can

Accreditation-and-MemberAccountability-Work [https://perma.cc/8EL4-WC5S]. Or as some commentators have proposed, it could be non-voluntary in that nonprofits would be subject to its oversight either as a matter of state law or as a condition on accessing federal tax benefits. *See, e.g.*, Maxwell B. Kallenberger, Comment, *Policing Charitable Organizations: Whose Responsibility Is It,* 76 LA. L. REV. 661, 685–86 (2015) (proposing non-voluntary state self-regulatory organization); Lloyd Hitoshi Mayer, *The Better Part of Valor Is Discretion: Should the IRS Change or Surrender Its Oversight of Tax Exempt Organizations*, 7 COLUM. J. TAX L. 80, 117–121 (2016) (proposing nonvoluntary national self-regulatory organization); Marcus S. Owens, *Charity Oversight: An Alternative Approach* (2013), https://academiccommons.columbia.edu/doi/10.7916/D8154F1D [https://perma.cc/4WFM-WBJW] (same). An example of such a non-voluntary, self-regulatory body outside of the nonprofit context is the Financial Industry Regulation Authority (FINRA), which oversees U.S. broker-dealers. FINRA, ABOUT FINRA, https://www.finra.org/about [https://perma.cc/Y9K3-YHKH].

6. *See* RESTATEMENT, *supra* note 1, §§ 5.01 & cmt. b(1) (attorneys general), 5.02 & cmt. a (courts and legislatures).

exercise this authority by bringing lawsuits varies significantly depending on the jurisdiction.[7]

More specifically, state attorneys general oversee charities, sometimes but not always through a mandatory registration and reporting system, investigate possible misuse of charitable assets and violations of fiduciary duties, and seek to remedy any such misuse or violations through negotiated settlements or by seeking judicial relief.[8] State judges decide whether legal remedies proposed by attorneys general are justified, often including remedies that are the result of a negotiated settlement, and also consider requests by charities to invoke the *cy pres* or deviation doctrines to change the purposes of or restrictions on charitable assets.[9] State legislatures enact statutes applicable specifically to charities, such as statutes enacted in many states which codify the attorney general's authority. In other states, legislatures have enacted statutes requiring registration and reporting by charities, imposing audit requirements on certain charities, and requiring notice to the attorney general in certain circumstances.[10] Generally, however, state legislatures do not directly supervise specific charities.[11]

7. *See id.* ch. 6, Introductory Note, §§ 6.01 to 6.05.
8. *See id.* § 5.01 & cmt. d(1) (powers), Rep. Note 11 (registration and reporting); MARION R. FREMONT-SMITH, GOVERNING NONPROFIT ORGANIZATIONS: FEDERAL AND STATE LAW AND REGULATION 305–07 (2004); Terri Lynn Helge, *Policing the Good Guys: Regulation of the Charitable Sector Through a Federal Charity Oversight Board*, 19 CORNELL J.L & PUB. POL'Y 1, 11–13 (2009).
9. *See* RESTATEMENT, *supra* note 1, §§ 3.02 (the doctrine of *cy pres* allows a court to change the purposes to which charitable assets are dedicated if those purposes become unlawful, impossible, impracticable or wasteful), 3.03 (the doctrine of deviation allows a court to modify an administrative term relating to charitable assets under certain circumstances), 5.01 cmt. b(1) (role of courts with respect to attorney general negotiated settlement agreements), 5.02 & cmt. b (role of state courts); FREMONT-SMITH, *supra* note 8, at 302–05; Evelyn Brody, *Whose Public? Parochialism and Paternalism in State Charity Law Enforcement*, 79 IND. L.J. 937, 954–56 (2004).
10. *See* RESTATEMENT, *supra* note 1, §§ 5.01 cmt. b(2) (statutes codifying attorney general role), cmt. c (notice to attorney general required in some states when, for example, a charity files an action seeking application of the doctrines of *cy pres* and deviation, when a charity seeks to end its legal existence, or when a probated will includes a charitable bequest), Rep. Note 11 at 5 (registration and reporting); FREMONT-SMITH, *supra* note 8, at 311–14 (statutes codifying attorney general role), 458 (some states require audited financial statements of charities of a certain financial size or that solicit funds from the public).
11. *See* RESTATEMENT, *supra* note 1, 5.02 cmt. a ("legislatures do not supervise charities"). There have been rare exceptions, most notably when the New York state legislature directed the disposition of proceeds from the conversation of Empire Blue Cross and Blue Shield and when the Pennsylvania state legislature enacted legislation designed specifically to counter the sale by the Milton Hershey School Trust of a controlling interest in the Hershey Foods Corporation. *See* Jill R. Horwitz & Marion R. Fremont-Smith, *The Common Law Power of the Legislature: Insurer Conversions and Charitable Funds*, 83 MILBANK Q. 225 (2005) (New York); Brody, *supra* note 9, at 996–97 (Pennsylvania).

As for private parties, almost all states grant current directors and trustees standing to bring derivative suits on behalf of charities, and some states grant former directors and trustees such standing in certain circumstances.[12] Many states also grant current members this standing, but often only if enough members act together, for example, 5 percent of all members. This standing may also extend to former members in certain circumstances.[13] Most but not all states permit private parties to act on behalf of the attorney general as relators—including with respect to oversight of charities—but only with the permission and under the oversight of the attorney general and subject to various other restrictions.[14]

The most varied areas are with respect to standing for donors and other parties with a "special interest."[15] While at one point donors and their successors simply lacked standing to enforce the terms of a previous gift, now there is a patchwork of rules. Some states still deny standing in all or almost all circumstances, others have standing determination turn on the legal form of charity involved, usually reflecting the adoption of the Uniform Trust Code, which now grants such standing to trust settlors, and others grant standing more broadly.[16] Finally, some states recognize standing for a private party with a special interest in the issue or assets at stake, particularly when the attorney general has refused to act, however, the definition of what constitutes a sufficient special interest also varies.[17]

12. *See* RESTATEMENT, *supra* note 1, § 6.02(a), (b)(2)(A), (B) & cmt. b(2), (4); DEBORAH A. DEMOTT, SHAREHOLDER DERIVATIVE ACTIONS: LAW AND PRACTICE § 2:12 (2021). For a recent California Supreme Court case on the circumstances, if any, under which former nonprofit directors and trustees have such standing, see *Turner v. Victoria*, 532 P.3d 1101 (2023) (granting petition for review of *Turner v. Victoria*, 67 Cal. App. 5th 1099 (2021)).
13. *See* RESTATEMENT, *supra* note 1, § 6.02(a), (b)(2)(C) & cmt. b(3), (4); DEMOTT, *supra* note 12, § 2:12; FREMONT-SMITH, *supra* note 8, at 334–36.
14. *See* RESTATEMENT, *supra* note 1, § 5.01 cmt. d(2); Mary Grace Blasko et al., *Standing to Sue in the Charitable Sector*, 28 U.S.F. L. REV. 37, 49–50 (1993); Susan N. Gary, *Regulating the Management of Charities: Trust Law, Corporate Law, and Tax Law*, 21 U. HAW. L. REV. 593, 626–27 (1999); Geoffrey A. Manne, *Agency Costs and the Oversight of Charitable Organizations*, WIS. L. REV. 227, 250 (1999).
15. *See* RESTATEMENT, *supra* note 1, §§ 6.02(a), (b)(2)(D) & cmt. b(5), 6.03 to 6.05.
16. *See id.* § 6.03 cmt. a; UNIF. TRUST CODE § 4.05(c) (UNIF. LAW COMM'N 2000); Nicole Anaya Watson, Note, *The Issue of Donor Standing and Higher Education: Will Increased Donor Standing Be Helpful or Hurtful to American Colleges and Universities*, 40 J. COLL. & UNIV. L. 321, 333–46 (2014).
17. *See* RESTATEMENT, *supra* note 1, § 6.05 & cmt. a; Blasko et al., *supra* note 14, at 61.

II. COMMON CRITICISMS OF THE EXISTING ALLOCATION OF AUTHORITY

A. Politicization

Commentators have long highlighted the fact that state attorneys general are elected or appointed and thereby influenced by political concerns, with two possible negative effects.[18] One alleged negative effect is underenforcement in some instances, such as when attorneys general are wary of challenging fiduciaries who are reputable members of the community, absent relatively egregious violations of their fiduciary duties.[19] The other alleged negative effect is overenforcement in other instances because pursuing an investigation or seeking a particular remedy may be politically advantageous, even if questionable on the merits.[20]

It is true that the attention and resources attorneys general devote to oversight of charities are relatively sparse in most states, as detailed in the next Part.[21] It is difficult to know, however, whether that lack is the result of the specific political concerns highlighted by commentators or instead the broader need of attorneys general to make difficult resource allocation decisions, including decisions based on public enforcement priorities.[22] If the latter is the primary driver, that arguably is a feature, not a bug, since attorney general enforcement priorities should be responsive to public opinion, including with respect to charities. Although Evelyn Brody has identified a few instances of possible undue restraint by an attorney general because of an unwillingness to challenge politically connected and respected fiduciaries, both the motives of the attorneys general in those situations and the pervasiveness of the effect of those motives remain unclear.[23]

As for overenforcement, the poster child for politicization is from Pennsylvania, where in 2002 the attorney general, who was running for governor at the time, successfully prevented the Milton Hershey School Trust ("Hershey Trust") from selling a controlling interest in the Hershey Foods Corporation

18. *See* BALLOTPEDIA, ATTORNEY GENERAL OFFICE COMPARISON, https://ballotpedia.org/Attorney_General_office_comparison [https://perma.cc/ZY4B-DNDT] (43 Attorney Generals elected, 7 appointed).
19. *See, e.g.*, Blasko, *supra* note 14, at 48–49; Brody, *supra* note 9, at 947–48; Kenneth L. Karst, *Efficiency of the Charitable Dollar: An Unfulfilled State Responsibility*, 73 HARV. L. REV. 433, 478–79 (1960).
20. *See, e.g.*, Brody, *supra* note 9, at 947–48.
21. *See infra* Subpart II.B.
22. *See, e.g.*, Brody, *supra* note 9, at 953 ("at some point we must concede that the public might not want to pay for more (or different) oversight than is occurring").
23. *See* Brody, *supra* note 9, at 949–50.

without court consideration of the proposed sale, which never occurred.[24] By one accounting, this action cost the Hershey Trust approximately $850 million or about 15 percent of its then value.[25] Yet even in this case, it is unclear how much the attorney general's position stemmed from political ambition and how much it stemmed from his recognition of the potential harm to the local community, which appeared to drive worker, alumni, and public opposition.[26]

A more recent example was the Michigan attorney general's attempt to force the Ford Foundation to make 20 percent of its grants to Michigan charities by offering to end an investigation into the Foundation if it did so.[27] The Foundation did not accept the offer, however, and the investigation did not find any wrongdoing, although the Foundation did begin making more grants to Michigan recipients.[28]

There also are two important checks on attorney general overenforcement in this area, one being resource constraints given the many responsibilities of attorneys general and the other being state courts.[29] On the latter point and as noted previously, if an attorney general wants to compel a charity or its fiduciaries to take or not take specific actions, she must go to court.[30] Commentators generally agree that the Pennsylvania courts failed in 2002 to be a check on the attorney general with respect to the Hershey Trust,[31] although one state appellate court judge dissented from the decision affirming the lower court's grant of a

24. *See, e.g.*, FREMONT-SMITH, *supra* note 8, at 446–47; Jonathan Klick & Robert H. Sitkoff, *Agency Costs, Charitable Trusts, and Corporate Control: Evidence From Hershey's Kiss-Off*, 108 COLUM. L. REV. 749 (2008); Peter Molk & D. Daniel Sokol, *The Challenges of Nonprofit Governance*, 62 B.C. L. REV. 1497, 1524–25 (2021).
25. Klick & Sitkoff, *supra* note 24, at 815.
26. Brody, *supra* note 9, at 991–92.
27. *See* Harvey Dale & Jill Horwitz, Opinion, *Michigan's Dangerous Attempt to Distort Donor's Intentions*, CHRON. OF PHILANTHROPY (Aug. 17, 2006), https://www.philanthropy.com/article/michigans-dangerous-attempt-to-distort-donors-intentions/ [https://perma.cc/TJN6-8JSZ].
28. Jennifer Chambers, *Ford Foundation's work doesn't end with 'grand bargain'*, DETROIT NEWS (Jan. 19, 2015), https://www.detroitnews.com/story/news/local/wayne-county/2015/01/19/ford-foundations-work-end-grand-bargain/21981269/ [https://perma.cc/BPK8-DXCQ].
29. *See, e.g.*, Brody, *supra* note 9, at 956 ("[a]vailability of court review can curb inappropriate regulator zeal—or willingness to compromise"); Iris J. Goodwin, *Donor Standing to Enforce Charitable Gifts: Civil Society vs. Donor Empowerment*, 58 VAND. L. REV. 1093, 1139 (2005) ("[l]ack of money, coupled with the obligation to discharge other important duties invites—indeed necessitates—selective prosecution").
30. *See supra* note 9 and accompanying text.
31. *See, e.g.*, Brody *supra* note 9, at 998–99; Jennifer L. Komoroski, Note, *The Hershey Trusts Quest to Diversify: Redefining the State Attorney General's Role When Charitable Trusts Diversify,* 45 WM. & MARY L. REV. 1769, 1790–91 (2004); Mark Sidel, *The Struggle for Hershey: Community Accountability and the Law in Modern American Philanthropy,* 65 U. PITT. L. REV. 1, 3 (2003).

preliminary injunction temporarily blocking the proposed sale.[32] But that situation may have been highly unusual, even unique,[33] and there are other examples of courts tempering what might have been politically motivated actions by the attorney general.

For example, the Minnesota Attorney General recently sought legal remedies, including the removal of the trustees of the Otto Bremer Trust, because of alleged breaches of fiduciary duty relating to the Trust's decision to sell part of its investment in the Bremer Financial Corporation, among other alleged breaches of fiduciary duty.[34] Unlike the Hershey Trust situation, the courts provided a more measured remedy, only removing one trustee and providing only some of the other relief sought.[35] Similarly, the New York attorney general recently brought suit against the National Rifle Association seeking the nonprofit corporation's dissolution for allegedly improperly benefitting insiders, including long-time chief executive officer Wayne LaPierre.[36] While the trial court is allowing the suit to proceed—and dismissed the NRA's counterclaims alleging the suit was improperly politically motivated—it has already rejected the draconian sanction of dissolution as unjustified even if the allegations are true.[37]

Finally, in a long-running dispute relating to the estate of musician James Brown, the South Carolina Attorney General initially obtained court approval of a settlement that included granting the attorney general sole authority to select the trustee for a charitable trust and reallocation of the estate proceeds among the estate's beneficiaries, including the charitable trust.[38] But the state Supreme Court had the final word, removing the authority of the attorney general to appoint the trustee of the charitable trust in favor of the trial court exercising that power and

32. In re Milton Hershey School Trust, 807 A.2d 324, 335 (Pa. Commw. Ct. 2002) (Pellegrini, J., dissenting).
33. *See* Sidel, *supra* note 31, at 39 (noting a rare confluence of circumstances relating to the Pennsylvania trial court in the Milton Hershey School Trust case).
34. In re Otto Bremer Trust, No. A21–0053, 2021 WL 3852250, at *1–2 (Minn. D. Ct. Aug 30, 2021).
35. *See id.* at *2, *6; Kavita Kumar, *Judge removes trustee at Otto Bremer Trust who pushed hardest for sale of Bremer Bank. But the judge said the trust has right to sell its ownership of Bremer Bank*, STAR TRIBUNE (Apr. 29, 2022), https://www.startribune.com/judge-removes-trustee-at-otto-bremer-trust-who-pushed-hardest-for-sale-of-bremer-bank/600169234/ [https://perma.cc/U3CB-U7H2] (reporting later trial court decisions).
36. People v. National Rifle Association, 165 N.Y.S.3d 234, 238–39 (2022).
37. *See id.* at 261 (granting motions to dismiss as to claims for dissolution and a couple other claims, but otherwise denying those motions); People v. National Rifle Association, No. 451625/2020, 2022 WL 2112889, at *1 (N.Y. S. Ct. June 10, 2022) (dismissing counterclaims the court characterized as asserting that the attorney general's lawsuit was "a politically motivated—and unconstitutional—witch hunt").
38. McMaster v. Bauknight, Nos. 08-CP-02–1647, 07-CP-02–0122, 08-CP-02–00872, 2009 WL 8731381, at *6, *20 (S.C. Com. Pl. May 26, 2009).

rejecting the agreed to reallocation of the estate proceeds.[39] The court's admonition of the attorney general is particularly noteworthy: "As the enforcer of charitable trusts, we believe the AG's efforts would have been better served in attempting to make a cursory evaluation of the claims rather than directing a compromise which ultimately resulted in the AG obtaining virtual control over Brown's estate. Based on all the circumstances, we do not believe the effect of the compromise is just and reasonable, and we cannot condone its approval."[40]

Finally, a few current or former state officials with responsibility for charity oversight in attorneys general offices have indicated publicly that in their experience attorney general offices act appropriately and provide effective oversight. For example, a then current Ohio Attorney General acknowledged the politicization concern but stated that "[n]evertheless, there is evidence to suggest that state attorneys general are at least somewhat effective in preserving charitable assets and disciplining fiduciaries."[41] A former Massachusetts Director of the Division of Public Charities in the state attorney general's office, and then law professor, similarly stated that she believed her office was "active and effective."[42]

B. Lack of Attention & Resources

Commentators have also long criticized the relatively low level of attention and resources that state attorneys general devote to overseeing charities.[43] Researchers at the Urban Institute have recently attempted to evaluate that level of oversight.[44] Using data gathered in 2013–14 from 41 attorney general offices, the

39. Wilson v. Dallas, 743 S.E.2d 746, 767–68 (S.C. 2013); *see also* Livia Gershon, *James Brown's Estate Has Sold After 15-Year Dispute*, SMITHSONIAN MAG. (Dec. 20, 2021), https://www.smithsonianmag.com/smart-news/james-browns-estate-has-sold-after-15-year-dispute-180979257/ [https://perma.cc/2MUE-M923].
40. *Id.* at 766.
41. Patton, *The Queen, the Attorney General, and the Modern Charitable Fiduciary: A Historical Perspective on Charitable Enforcement Reform*, 11 U. FLA. J.L. & PUB. POL'Y 131, 164–65, 167 (2000).
42. Catharine P. Wells, *Holding Charities Accountable: Some Thoughts from an Ex-Regulator*, at 1 (2006), https://lira.bc.edu/work/ns/1da423fb-4450-4c0e-8266-2fabd5a06e73 [https://perma.cc/PW83-EAUW].
43. In chronological order, *see, e.g.*, Karst, *supra* note 19, at 452–56 (1960); Henry B. Hansmann, *Reforming Nonprofit Corporation Law*, 129 U. PA. L. REV. 497, 601 (1981); James J. Fishman, *The Development of Nonprofit Corporation Law and an Agenda for Reform*, 34 EMORY L.J. 617, 668–69 (1985); Blasko, *supra* note 14, at 38–39 (1993); Garry W. Jenkins, *Incorporation Choice, Uniformity, and the Reform of Nonprofit State Law*, 41 GA. L. REV. 1113, 1128–29 (2007) (74 percent of state attorneys general offices had one or fewer full-time equivalent attorneys monitoring charities).
44. *See* URBAN INSTITUTE, REGULATION OF NONPROFITS AND PHILANTHROPY PROJECT, https://www.urban.org/policy-centers/center-nonprofits-and-philanthropy/projects/regulation-charitable-sector-project [https://perma.cc/37ZV-ZUCN].

researchers found that there were 355 state charity regulators in the United States, including both attorneys and nonattorney support staff, with more than half of the responding attorney general offices having fewer than three full-time equivalents.[45]

However, the question that this criticism begs is whether the current level of enforcement is actually too low given the amount of malfeasance by charities and their fiduciaries, and given the other areas requiring government oversight.[46] Unfortunately, there is an almost complete lack of empirical data regarding the former.[47] The few researchers who have tried to quantify wrongdoing at charities have had to rely on surveys of newspaper reports, which are necessarily anecdotal and incomplete.[48] Recently the National Association of State Charity Officials has released reports of enforcement and other actions, but they only include cases and other information that attorneys general choose to share.[49]

The increased data available through mandatory electronic filing of IRS returns and its availability in machine readable format holds the promise of more complete data regarding the aspects of tax-exempt nonprofits reported on those

45. CINDY M. LOTT ET AL., STATE REGULATION AND ENFORCEMENT IN THE CHARITABLE SECTOR 3, 8 (2016), https://www.urban.org/research/publication/state-regulation-and-enforcement-charitable-sector [https://perma.cc/6FMV-46RQ]. Based on the limited data available, there is some but not complete correlation between the number of charities and the number of state regulators in each state. *Compare* Jenkins, *supra* note 43, at 8 (full-time equivalent (FTE) attorneys monitoring charities in state attorneys general offices based on a survey done for an article published in 2007) *with* Kenneth T. Wing, Thomas H. Pollack & Amy Blackwood, THE NONPROFIT ALMANAC 2008, at 202–04 (2008) (number of non-private foundation charities reporting to the IRS in 2005 by state).

46. *See* Rob Atkinson, *Unsettled Standing: Who (Else) Should Enforce the Duties of Charitable Fiduciaries*, 23 J. CORP. L. 655, 683–84 (1998) (making this point).

47. Lloyd Hitoshi Mayer, *The Better Part of Valor Is Discretion: Should the IRS Change or Surrender Its Oversight of Tax Exempt Organizations*, 7 COLUM. J. TAX L. 80, 94–95 & n.84 (2016) (information regarding tax-exempt nonprofit violations of federal tax laws and related violations of state and local laws is "almost completely anecdotal" and listing sources); PETER SWORDS & HARRIET BOGRAD, NONPROFIT ACCOUNTABILITY: REPORT AND RECOMMENDATIONS 2 (1997) (on file with author) ("it appears to be impossible or impracticable to obtain definitive, empirical answers to the question of what types of problems occur and how pervasive they are").

48. *See* Marion Fremont-Smith & Andras Kosaras, *Wrongdoing by Officers and Directors of Charities: A Survey of Press Reports 1995–2002*, 42 EXEMPT ORG. TAX REV. 25 (2003); Marion R. Fremont-Smith, *Pillaging of Charitable Assets: Embezzlement and Fraud*, 46 EXEMPT ORG. TAX REV. 333 (2004) (focusing on wrongdoing by lower-level employees).

49. NATIONAL ASSOCIATION OF STATE CHARITIES OFFICIALS (NASCO) ANNUAL REPORT ON STATE ENFORCEMENT AND REGULATION: JANUARY 2019—MARCH 2020, https://www.nasconet.org/2020-annual-report [https://perma.cc/TR57-FDBL] (2020) (providing a "representative sample" of cases and other initiatives); UPDATE FROM STATE ATTORNEYS GENERAL: CURRENT DEVELOPMENTS IN REGULATION AND ENFORCEMENT, https://www.nasconet.org/annual-reports/2019-annual-report [https://perma.cc/K8DS-RTCY] (2019).

filings.[50] For example, a recent study by Peter Molk and D. Daniel Sokol of IRS filings has determined that many large nonprofits lack conflict of interest policies, especially nonprofits with a minority of independent directors.[51] A subsequent study by Molk, also based on IRS filings, argues that there is at least "a stroll to the bottom" in terms of nonprofits seeking to incorporate in jurisdictions with weaker oversight of nonprofits.[52] These studies, however, do not show the extent to which actual breaches occur, but rather show, at most, that a significant number of charities have fewer internal and external checks for conflicts of interest and other potential breaches of fiduciary duties as compared to other charities.

Despite this limited information, commentators reasonably raise concerns about the adequacy of state charity oversight. Still, this lack of data suggests caution when considering how to reallocate authority for that oversight among state government actors and private parties, lest the cure be worse than the disease.

III. PROPOSALS FOR REALLOCATING AUTHORITY

To address the above concerns commentators have proposed various oversight reforms, including through reallocating state level authority.[53] The two types of proposals most relevant for this Essay are: (1) proposals to shift attorney general authority to another entity; and (2) proposals to expand the authority of private parties by increasing the scope of private party standing to bring lawsuits against charities and their fiduciaries.[54] This Part first considers these two types of proposals and explains why I reject them, before discussing more modest reforms that I support.

A. Shifting Attorney General Authority to Another Entity

More than 60 years ago, Kenneth L. Karst proposed the creation of a new state agency "to bear primary responsibility for supervising private charities and for

50. *See* Taxpayer First Act, Pub. L. No. 116–25, § 3101, 133 Stat. 981, 1015–16 (2019) (amending among other sections I.R.C. §§ 6033(n) (mandatory electronic filing) and 6104(b) (requiring making annual returns available to the public in machine readable format)).
51. Molk & Sokol, *supra* note 24, at 1518.
52. Peter Molk, *Where Nonprofits Incorporate and Why It Matters*, 108 IOWA L. REV. 1781, 1823 (2023).
53. *See, e.g.*, Lloyd Hitoshi Mayer & Brendan M. Wilson, *Regulating Charities in the Twenty-First Century: An Institutional Choice Analysis*, 85 CHI.-KENT L. REV. 479, 495–504 (2010) (summarizing reform proposals, including at the state level); Patton, *supra* note 41, at 169–75 (summarizing state-level reform proposals).
54. Other reform proposals, such as changing the legal rules applicable to charities and their fiduciaries or shifting authority to the federal level, are beyond the scope of this Essay.

administering the various state controls over their operation."[55] His primary reason for this proposal to shift these responsibilities away from attorneys general and courts was to enhance oversight of charities through centralization, specialization, and de-politicization.[56] Relatedly, James J. Fishman has proposed the creation of new bodies to exercise at least a portion of current attorney general responsibilities with respect to charities, specifically voluntary citizen advisory charity commissions to initially review and investigate complaints under the supervision of the attorney general's office.[57]

The problem with these proposals is they assume the prevention or countering of misuse of charity assets and violations of fiduciary duties justifies the additional burden they place on charities, both in the form of having to respond to presumably an increased number of inquiries from the new entities and possibly having to pay fees to fund any new entity as noted by a symposium attendee.[58] As already noted, however, the scale of that bad behavior is not known.[59] The creation of these new entities also lessens the attorney general's control over both the overall volume of investigations and specific investigatory decisions, which might be undesirable exactly because it lessens political responsiveness.

B. Expanding the Authority of Private Parties

There have also been numerous proposals to expand the authority of private parties in various ways.[60] These fall mostly into three categories: (1) loosening the restrictions on using relators;[61] (2) giving donors and their successors standing to

55. Karst, *supra* note 19, at 476.
56. *Id.* at 477–81.
57. James J. Fishman, *Improving Charitable Accountability*, 62 MD. L. REV. 218, 272–75 (2003); *see also* Avner Ben-Ner & Theresa Van Hoomissen, *The Governance of Nonprofit Organizations: Law and Public Policy*, 4 NONPROFIT MGMT. & LEADERSHIP 393, 409 (1994) (proposing the creation of state offices of nonprofit organizations to aid nonprofits and their stakeholders).
58. *See* Fishman, *supra* note 57, at 268, 272 (predicting that significantly increased funding for enforcement activity at either the federal or state level is unlikely).
59. *See supra* notes 47–49 and accompanying text.
60. *See* FREMONT-SMITH, *supra* note 8, at 336–38 (summarizing proposals); Brian Galle, *Design and Implementation of a Charitable Regulation Regime, in* RESEARCH HANDBOOK ON NOT-FOR-PROFIT LAW 530, 537-42 (Matthew Harding ed., 2018) (same); Mayer & Wilson, *supra* note 53, at 482 n.14 (same); Patton, *supra* note 41, at 169–73 (same).
61. *See, e.g.*, Ronald Chester, *Improving Enforcement Mechanisms in the Charitable Sector: Can Increased Disclosure of Information Be Utilized Effectively*, 40 NEW ENG. L. REV. 447, 472, 476 (2005); Fishman, *supra* note 43, at 671–74; Gary, *supra* note 14, at 647; Harvey J. Goldschmid, *The Fiduciary Duties of Nonprofit Directors and Officers: Paradoxes, Problems, and Proposed Reforms*, 23 J. CORP. L. 631, 652–53 (1998).

challenge the use of restricted gifts;[62] and (3) broadening the definition of what constitutes a "special interest" sufficient for standing purposes.[63] In addition, during this symposium a couple attendees suggested the possibility of creating a *qui tam* action for charity or charity leader malfeasance, which is a form of relator action that primarily exists under federal and state false claims acts.[64]

As with the shifting authority proposals, the problem with these proposals is they rest on the assumption that the prevention or countering of misuse of charity assets and violations of fiduciary duties justifies the additional burden on charities, in the form here of having to defend against increased litigation.[65] Indeed, commentators in this area acknowledge the risk of increased litigation that primarily drains charity assets as opposed to preventing or countering wrongdoing.[66] This is particularly true for proposals that allow donor successors to challenge the use of restricted gifts, since they presumably are more likely than the original donor to be interested in regaining control of the gift–whether for their own benefit or to redirect to a different charity–than enforcing the purpose or terms of the gift.[67] Even proposals expanding the role of relators who operate

62. *See, e.g.*, Ben-Ner & Hoomissen, *supra* note 57, at 410; Ronald Chester, *Grantor Standing to Enforce Charitable Transfers Under Section 405(c) of the Uniform Trust Code and Related Law: How Important Is It and How Extensive Should It Be?*, 37 REAL PROP. PROB. & TR. J. 611, 629 (2003); Goodwin, *supra* note 29, at 1160–62; Hansmann, *supra* note 43, at 609–10; Lisa Loftin, *Protecting the Charitable Investor: A Rationale for Donor Enforcement of Restricted Gifts*, 8 B.U. PUB. INT. L.J. 361 (1999); Reid Kress Weisbord & Peter DeScioli, *The Effects of Donor Standing on Philanthropy: Insights from the Psychology of Gift-Giving*, 45 GONZ. L. REV. 225, 252–54 (2009). For purposes of this Essay, it will be assumed that such proposals do not give the donor or their successors sufficient control over the gift to render it incomplete legally, which would undermine the donor's ability to take a charitable contribution deduction for federal tax purposes. *See* Chester, *supra*, at 622–24 & n.56, 59 (discussing this issue).

63. *See, e.g.*, Gary, *supra* note 14, at 647–48. These proposals go beyond standardizing the application of the special interest doctrine for the sake of consistency and predictability. *See* RESTATEMENT, *supra* note 1, § 6.05; Blasko et al., *supra* note 14, at 83–84.

64. *See* 31 U.S.C. §§ 3729–3733 (federal False Claims Act); *see, e.g.*, CAL. GOV'T CODE §§ 12650–12656 (state False Claims Act).

65. In contrast to the lack of data regarding the relationship between shifting authority and preventing the misuse of charity assets or other violations of fiduciary duties, Brian Galle has found that for the subset of charities known as private foundations there is empirical evidence that donor standing reduces administrative overhead costs and is correlated with increased donations. Brian Galle, *Valuing the Right to Sue: An Empirical Examination of Nonprofit Agency Costs*, 60 J. L. ECON. 413, 437 (2017).

66. *See, e.g.*, Blasko et al., *supra* note 14, at 82; Evelyn Brody, *The Limits of Charity Fiduciary Law*, 57 MD. L. REV. 1400, 1431–32 (1998); Fishman *supra* note 43, at 670; Goldschmid, *supra* note 61, at 652.

67. *See, e.g.*, JAMES J. FISHMAN, THE FAITHLESS FIDUCIARY AND THE QUEST FOR CHARITABLE ACCOUNTABILITY 1200–2005, at 66 (2007); Evelyn Brody, *From the Dead Hand to the Living Dead: The Conundrum of Charitable-Donor Standing*, 41 GA. L. REV. 1183, 1259 (2007); Goodwin, *supra* note 29, at 1160.

under the supervision of the attorney general raise these concerns, including because they enhance the ability of wealthy private parties to influence enforcement priorities as opposed to public preferences more generally, thereby raising equity issues.[68] The *qui tam* suggestion further risks incentivizing frivolous lawsuits by private parties seeking to enrich themselves, since such actions provide a means for private citizens, who allegedly have independently obtained knowledge of illegality, to profit financially.[69]

C. More Modest Reform Proposals

As the above discussion indicates, I am skeptical of ambitious reform proposals, especially given the lack of data regarding the pervasiveness of wrongdoing by charities and their fiduciaries under state law. That said, one important aspect of the Restatement is it has identified several gaps in oversight in at least some states, the closure of which could enhance oversight with little if any downsides for charities generally. These gaps include: the lack of court involvement with respect to some attorney general negotiated settlements with charities;[70] the inability of current trustees and directors (in a few states)[71] and of members (in more states) to bring derivative suits;[72] and the inability of donors to enforce the negotiated terms of significant gifts in some states.[73] Unlike the bolder reform proposals, closing these gaps has the potential to enhance oversight of charities without substantially burdening them, especially given the apparent lack of significant negative effects in jurisdictions where these rules are already in place.

For court approval of settlements, the attorney general would primarily bear the burden of seeking that approval, and in most cases the courts would likely approve the settlement as appropriate with only minimal input needed from the charity involved. The requirement of court approval would serve as a check on any attorney general politicization of the settlement process. Consideration would

68. Another, related concern is that relators may favor lawsuits from which they expect to receive a financial return. Manne, *supra* note 14, at 250.

69. *See, e.g.*, Christina Orsini Broderick, Note, *Qui Tam Provisions and the Public Interest: An Empirical Analysis*, 107 COLUM. L. REV. 949 (2007) (studying *qui tam* actions under federal and state false claims acts and concluding that while they enhance detection and deterrence of fraud against governments, they should be limited in several ways to minimize the number of frivolous suits).

70. RESTATEMENT, *supra* note 1, § 5.01 cmt. b(1) ("in practice, state attorneys general sometimes enter into settlement agreements without submitting the agreements to a court for approval").

71. RESTATEMENT, *supra* note 1, § 6.02 cmt. b(2) & Rep. Notes 12 & 13; *see, e.g.*, Doemer v. Callen, 847 F.3d 522, 532 (7th Cir. 2017) (concluding a nonprofit corporation's non-member director did not have standing to bring a derivative claim under Indiana law).

72. RESTATEMENT, *supra* note 1, § 6.02 cmt. b(3) & Rep. Note 17.

73. RESTATEMENT, *supra* note 1, § 6.03 cmt. a.

have to be given to the public nature of this approval process, since a charity would usually not want to publicly admit any wrongdoing, but as is the case in many other contexts, that issue could be managed by the attorney general's office while still achieving any needed corrections.[74] If that presumption is incorrect, consideration also could be given to limiting the court approval requirement to settlements relating to alleged misuse of charitable assets, as opposed to alleged violations of fiduciary duty that might have a more negative public relations effect if made public, as one symposium attendee suggested. It might also be necessary for the state legislature to develop some standards for approval of settlements to ensure the court review is meaningful as opposed to cursory, as also suggested by a symposium attendee.

Since governing body members both are usually in the best position to know about potential significant wrongdoing and have an interest in the charity operating appropriately, it is not surprising that most states grant them standing to bring derivative suits challenging alleged wrongdoing. That rule should therefore apply in the few states that, likely because of historical inertia more than conscious choice by state legislatures, do not currently grant this standing.[75] For the same reason, when a charity has members in a legal sense—that is, who exercise some level of governance authority—a sufficient proportion of those members should have standing to bring derivative suits in those states that currently do not provide that standing, as well.[76] Consideration should also be given to extending these standing proposals to former members and governing body members in certain circumstances, such as if they were in that position when the alleged improper behavior occurred or if they are removed from membership or the governing body in an attempt to deprive them of standing.[77]

Finally, the problems identified with expanding the standing of donors and their successors with respect to enforcing gift terms likely mostly arise with the successors, not the donors themselves, who presumably gave the gift because of interest in supporting a particular aspect of the charity's mission.[78] At least where the gift is significant, relative to the financial size of the charity, the donor, but not their heirs or other successors, should have standing to enforce the negotiated terms of that gift pursuant to an individualized

74. *See generally* Verity Winship & Jennifer K. Robbennolt, *Admissions of Guilt in Civil Enforcement*, 102 MINN. L. REV. 1077 (2018).
75. *See* Karst, *supra* note 19, at 443–445 (making this point).
76. *See, e.g.*, Hansmann, *supra* note 43, at 613 (supporting member standing).
77. *See* RESTATEMENT, *supra* note 1, § 6.02(a) cmt. b(4).
78. *But* see Weisbrod & DeScioli, *supra* note 62, at 288 (questioning whether donor standing protects charitable assets, much less sufficiently to justify the costs to charities of donor enforcement litigation).

express written contract relating to the gift, assuming one exists.[79] This is consistent with the Uniform Trust Code's provision relating to settlor standing.[80] While this proposal does not address the bequest situation, the standing could extend to the administrator of the donor's estate. Beyond the life of the estate there are already mechanisms by which donors in that situation can grant third parties—particularly alternate beneficiaries—standing to enforce gift terms as a party with a special interest, even if the attorney general fails to act.[81] If a charity explicitly agrees to a gift with this type of third party provision, it is on notice and indeed has voluntarily accepted that a burden accompanying the gift is the possibility of such party being able to enforce its terms.

CONCLUSION

An important benefit of Restatements is the identification of inconsistencies within the common law and codifications of the common law. The Restatement of Charitable Nonprofit Organizations provides this benefit, particularly with respect to the allocation of state authority over charitable nonprofit organizations. At the same time, concerns about politicization and relatively low levels of attorney general oversight do not justify more radical reallocation proposals, such as shifting attorney general authority to entirely new state entities or expanding private party standing to sue charities in other ways. This is because political responsiveness is a desirable feature of attorney general authority, and the courts serve as a significant check on overenforcement in the instances where attorneys general actions could be adversely affected by political concerns.. Further, there is insufficient data to justify the need for increased enforcement, whether by attorneys general or others wielding their current authority. Rather, many jurisdictions require court approval of attorney general negotiated settlements, permit directors, trustees, and some portion of any membership to bring derivative suits, and permit donors of substantial gifts to enforce explicitly agreed to written gift terms. Given that these jurisdictions have implemented such reforms without apparently overburdening charities generally or causing other significant adverse effects, these rules should be adopted by all jurisdictions.

79. *See, e.g.*, Brody, *supra* note 67, at 1265 (proposing a threshold); Karst, *supra* note 19, at 447 (same); Chester, *supra* note 62, at 630–32 (individualized express contract).
80. *See* UNIF. TRUST CODE § 405(c) (UNIF. LAW COMM'N 2000).
81. *See* Brody, *supra* note 67, at 1262 (alternate beneficiaries); Chester, *supra* note 62, at 629 (estate administrator).