

LET CHARITABLE DIRECTORS DIRECT: WHY TRUST LAW
SHOULD NOT CURB BOARD DISCRETION OVER A CHARITABLE
CORPORATION'S MISSION AND UNRESTRICTED ASSETS

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INTRODUCTION

People organize and contribute to charities in order to pursue particular charitable objectives. Each charity's governing body also pursues charitable objectives, but these are not necessarily the same as those of the charity's organizers or contributors. Sometimes, this gap between the objectives of a charity's philanthropists (i.e., organizers, donors, and volunteers) and its "philanthropoids" (i.e., the trustees of a charitable trust, the directors or officers of a charitable corporation, etc.) represents a failure of accountability, as when a charity uses a restricted gift in ways that violate the donor's explicit instructions. The legal form most closely associated with the "follow-the-philanthropist's" conception of accountability is the charitable trust, which arises when a donor (a.k.a. "settlor") executes a written instrument directing the trustee to use the donated property for a specific charitable purpose.

Other times, it is harder to determine whether a gap exists between the philanthropists' and philanthropoids' charitable objectives, and, if so, whether the gap represents a failure or fulfillment of accountability's demands. This may be the case in some charitable corporations that are funded mainly by "unrestricted" gifts.¹ If the corporate board amends its charitable purposes, does it break faith with the donors of unrestricted gifts

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1. See RESTATEMENT (THIRD) OF TRUSTS § 28 cmt. a (2003) ("An outright devisee or donation to a . . . charitable institution, expressly or impliedly to be used for its general purposes . . . does not create a trust as that term is used in this Restatement.").

(a.k.a. “general donors”) if it applies their gifts to those amended purposes?² Or is there a “competing narrative” so to speak—that the board acts responsibly by attempting “to keep the purpose of the charity current and useful,”³ and by redirecting its unrestricted assets to purposes that “the board perceives to be . . . more socially useful”?⁴ Does the board act *responsively* to general donors, who may have structured their gifts so as to enable the board to respond to changing needs and new opportunities?

Lastly, what does the concept of accountability mean for a nonmembership⁵ charitable corporation that relies mainly on nondonated sources of revenue, such as “earned income and investment income (other than on gifts)”?⁶ One might say the entity is accountable insofar as it does not stray from the statement of charitable purposes set forth in the articles of incorporation,⁷ but that may not be saying much. The modern trend in nonprofit corporate law has been to accord corporation boards extensive—if not plenary—authority to redefine the organization’s charitable objectives⁸ and to use the organization’s resources (with the exception of restricted gifts) to advance those new objectives.⁹ This trend reflects a broader policy of “corporate law parallelism.”¹⁰ This policy seeks to pattern nonprofit corporate

2. Compare Am. Law Inst., Principles of the Law of Nonprofit Orgs., § 245 rptr’s note 2 (Council Draft No. 1, Oct. 2, 2003) [hereinafter ALI, Nonprofit Law, Council Draft No. 1] (“[T]hese Principles do not prohibit unrestricted pre-amendment assets [including pre-amendment unrestricted gifts] from being used for the new purpose.”), with Attorney General v. Hahnemann Hosp., 494 N.E.2d 1011, 1021 (Mass. 1986) (stating that although corporate board can change its charitable purpose by amending its articles of incorporation, pre-amendment restricted gifts may not be used for the new purpose).

3. ALI, Nonprofit Law, Council Draft No. 1, *supra* note 2, § 240 gen. cmts.

4. *Id.* § 240 rptr’s note 13 (discussing state nonprofit hospital conversion statutes that “curtail the [corporate board’s] freedom . . . to liquidate its assets and redeploy the proceeds to what its board perceives to be a more socially useful purpose”).

5. In a membership nonprofit corporation, there are persons entitled to vote for the election of a director or directors. REVISED MODEL NONPROFIT CORP. ACT § 1.40(21) (1987). These electors (a.k.a. “members”) are typically “those persons for whose benefit the corporation operates.” *Id.* § 6.10 cmt. In a nonmembership nonprofit corporation, by contrast, the directors typically select their own successors, a.k.a. a “self-perpetuating” board, and are not formally answerable to any stakeholder or group of stakeholders. *Id.* § 8.04.

6. ALI, Nonprofit Law, Council Draft No. 1, *supra* note 2, § 245 gen. cmts.

7. Dana Brakman Reiser, *Enron.org: Why Sarbanes-Oxley Will Not Ensure Comprehensive Nonprofit Accountability*, 38 U.C. DAVIS L. REV. 205, 208, 212–13 (2004) (explaining that to be deemed accountable, a nonprofit organization must, *inter alia*, adhere to its mission as set forth in its organic documents).

8. See, e.g., ALI, Nonprofit Law, Council Draft No. 1, *supra* note 2, § 240(b)(1) (“A charity other than a charitable trust may change its purpose to another charitable purpose by . . . [a]mending its articles of incorporation.”).

9. See, e.g., *id.* § 245(b) (“A charity other than a charitable trust may use its assets, other than restricted gifts imposing contrary requirements, for any pre- or post-amendment purpose.”).

10. See MODEL NONPROFIT CORP. ACT vii (1964) (referring to the policy “of bringing the text [of the MNCA] still more closely in accord with the Model Business Corporation Act”); MODEL NONPROFIT CORP. ACT iv, vii (1957).

law after the law of for-profit or business corporations,¹¹ whose boards are authorized to “set[] the course of the enterprise by determining the company’s general objectives, goals, and philosophies.”¹² For this reason, mission accountability in nonmembership, nondonative charitable corporations may seem vacuous: the board displays accountability by adhering to the charitable objectives it has elected to pursue, not to alter, or both—unless and until it elects to alter them.

In recent years, a growing number of commentators and state governments have expressed concern or displeasure over “the seeming unbounded discretion in a corporate board to alter the charity’s purpose.”¹³ In their search for legal doctrines to limit this discretion, some of these critics have looked to trust law principles for ideas and inspiration.¹⁴ This movement¹⁵—call it “trust law parallelism”—regards the charitable trust and

11. *See, e.g., Stern v. Lucy Webb Hayes Nat’l Training Sch.*, 381 F. Supp. 1003, 1013 (D.D.C. 1974) (mem.) (“[T]he modern trend is to apply corporate rather than trust principles in determining the liability of the directors of charitable corporations, because their functions are virtually indistinguishable from those of their ‘pure’ corporate counterparts.”); REVISED MODEL NONPROFIT CORP. ACT § 8.30 & cmt. 1 (1987) (commenting that the RMNCA’s standards of conduct for nonprofit directors track the language of the Model Business Corporation Act, thereby settling “the dispute as to whether directors of nonprofit corporations should meet the general business standards or the trustee standards”); MARION R. FREMONT-SMITH, *GOVERNING NONPROFIT ORGANIZATIONS: FEDERAL AND STATE LAW AND REGULATION* 152 (2004) (recounting that the RMNCA rejected the trust law standards for nonprofit corporation fiduciaries, which “had theretofore been the law in a number of jurisdictions”).

12. JAMES D. COX ET AL., *CORPORATIONS* 154 (1997).

13. ALI, *Nonprofit Law*, Council Draft No. 1, *supra* note 2, § 240 rptr’s note 12 (citing several articles in which commentators proposed legislation for greater state input when a corporate board seeks to make organic changes in a charity’s mission).

14. *See, e.g., FREMONT-SMITH, supra* note 11, at 440 (“In terms of effective and efficient regulation of the charitable sector, the English rule that the assets of charitable corporations are subject to the doctrines of cy pres and deviation, *regardless of their source, and regardless of whether they were given subject to explicit restrictions*, is clearly preferable,” with the caveat that these doctrines “should be applied liberally.”) (emphasis added); *Banner Health Sys. v. Long*, 663 N.W.2d 242, 250 (S.D. 2003) (explaining there are legal theories that would permit the imposition of a charitable trust on the general assets of a nonprofit health care corporation selling its assets).

15. An Arlo Guthrie song contains an enjoyable take on how many people it takes to constitute a movement:

You know, if one person, just one person does it they may think he’s really sick and
they won’t take him.
And if two people, two people do it, in harmony, they may think they’re both [homosexuals]
and they won’t take either of them.
And three people do it, three, can you imagine, three people walking in singin a bar of Alice’s
Restaurant and walking out.
They may think it’s an organization.
And can you, can you imagine fifty people a day, I said fifty people a day walking in singin a
bar of Alice’s Restaurant and walking out.
And friends they may thinks it’s a movement.
And that’s what it is , the Alice’s Restaurant Anti-Massacre Movement.

ARLO GUTHRIE, *Alice’s Restaurant Massacre*, on ALICE’S RESTAURANT (Reprise 1966), available at http://www.arlo.net/lyrics/Alices_Restaurant_Massacre.shtml.

trust law as exemplars of mission accountability in charitable organizations; it thus advocates the importation of more trust law principles into the law of charitable corporations. More specifically, it proposes changing two default rules in nonprofit corporate law to make it harder for boards to redirect corporate missions and assets, unless a corporate founder or unrestricted donors provide otherwise. First, it would impose a “duty of obedience” on corporate directors, obliging them to adhere to the corporation’s original mission, absent extraordinary circumstances (e.g., the mission has become impossible, illegal, or impracticable to pursue).¹⁶ This duty, it is said, is modeled after the trustee’s duty to “administer[] a trust in a manner faithful to the expressed wishes of the creator.”¹⁷ Second, trust law parallelism would impress a trust on a charitable corporation’s unrestricted gifts (and perhaps additional assets) for those charitable purposes set forth in its articles of incorporation (and perhaps those manifested in its operations) at the time such gifts were received.

This Article examines and evaluates the policy of trust law parallelism and its platform for changing the default rules for charitable corporations. To advance this analysis, it draws on the tools of economic agency theory and Professor Robert Sitkoff’s use of agency theory to analyze and help evaluate the private donative trust—a close cousin of the charitable trust. Under Sitkoff’s view, the private trust can be seen as dominated by the principal-agent relationship between the settlor and trustee, respectively, in which the settlor engages the trustee to advance the interests of the trust’s beneficiaries (cast as a second principal to the trustee) according to the settlor’s instructions. As a normative matter, he claims, trust law should recognize the settlor as its primary principal. The Article then draws on this approach and agency theory more broadly to analyze the charitable trust.

This Article argues that agency theory in general and an agency analysis of trust law in particular potentially offer two lessons for the law of charitable corporations. First, one might conclude that the way to promote mission accountability in charitable corporations is to identify corporate analogues to the settlor-trustee relationship and import trust law principals into nonprofit corporate law to address the analogous agency problems triggered by these relationships. This is the lesson that trust law parallelism draws from the settlor-trustee relationship, which it applies to two alleged

16. Cf. ALI, *Nonprofit Law*, Council Draft No. 1, *supra* note 2, § 240(c)(1) (providing a charitable corporation may change its charitable purpose to another charitable purpose without a determination by its governing board “that the current purpose of the charity has failed”).

17. DANIEL L. KURTZ, *BOARD LIABILITY: GUIDE FOR NONPROFIT DIRECTORS* 85 (1988) (citations omitted).

principal-agent relationships in the corporate context: founder-board and general donor-board. The Article argues that trust law parallelism does not adequately justify why the founder and general donors should be deemed the primary principals.

The second lesson one might draw from an agency analysis of trust law is that maintaining a diversity of legal forms and default rules for charitable activities reduces the time and money (a.k.a. “transaction costs”) that philanthropists must incur in modifying such forms and rules to best suit their needs and preferences, which in turn could increase the volume of charitable activity. This Article argues that diversity of form and rules is the correct lesson, and that the lesson argues in favor of corporate law parallelism and against trust law parallelism. Lastly, it argues that default rules for charitable corporations that provide boards with extensive discretion—i.e., corporate law parallelism—work best for informed philanthropists who appreciate the differences between charitable corporations and charitable trusts, but that those same default rules raise a number of problems when applied to uninformed philanthropists.

The Article proceeds as follows. Part I surveys the relevant law of charitable trusts and charitable corporations, focusing on the default rules for changing a charity’s objectives and using previously acquired unrestricted gifts to advance the new objectives. Part II discusses “trust law parallelism” and the two trust-inspired doctrines it advocates to promote mission accountability in charitable corporations. Part III provides a quick primer on economic agency theory, discusses Professor Robert Sitkoff’s use of agency theory to analyze and evaluate the law of private donative trusts, and offers an agency perspective on the law of charitable trusts. Part IV considers the implications of agency theory and an agency analysis of trust law for the law of charitable corporations. It assesses and rejects trust law parallelism, and it considers how corporate law parallelism affects philanthropists who are aware of the differences between charitable corporations and charitable trusts, as opposed those who do not appreciate this distinction.

I. CHARITY LAW AND MISSION ACCOUNTABILITY

This section presents the charitable trust, the charitable corporation, and each form’s default rules regarding the governing body’s control over the charity’s purposes and assets. The rules give corporate boards far more discretion over these matters than charitable trustees enjoy.

A. *Nonprofit and Charitable Organizations*

Nonprofit organizations are formed for some purpose or objective other than maximizing their net earnings.¹⁸ A nonprofit is bound by the “nondistribution constraint,” which bars it from distributing money or assets to organizational insiders (e.g., members of its governing body)¹⁹ except as reasonable payment for goods or services rendered.²⁰ A nonprofit’s earnings, if any, must be used to advance the organization’s mission, for example, by increasing the output of the services and goods it was formed to provide.²¹

A charitable organization is a nonprofit formed for one of the purposes defined as “charitable”; these include the relief of poverty, the advancement of education or religion, and “other purposes that are beneficial to the community.”²² A charity typically is organized as either a charitable trust or nonprofit corporation. The archetypal charitable trust is created when a donor (“settlor”) executes a written instrument²³ that obligates another party (the “trustee”) to use the donated property for a charitable purpose.²⁴ The trustee is subject to the fiduciary duties of loyalty (i.e., to subordinate his interests the trust)²⁵ and care (i.e., to exercise reasonable care and skill in administering the trust).²⁶ A donor can also create a charitable trust²⁷ or its equivalent²⁸ within a charitable corporation by making a gift to the en-

18. This purpose need not be charitable, as in the case of mutual benefit organizations.

19. Professor Henry Hansmann calls this prohibition the “nondistribution constraint,” which he posits as the nonprofit organization’s essential characteristic. Henry B. Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835, 838 (1980).

20. *Id.*; FREMONT-SMITH, *supra* note 11, at 248–49.

21. Hansmann, *supra* note 19, at 838.

22. RESTATEMENT (THIRD) OF TRUSTS § 28 (2003). “The definition of charity set forth in the Restatement of the Law of Trusts controls across the board, from inheritance disputes to federal tax law.” Evelyn Brody, *Charity Governance: What’s Trust Law Got to Do with It?*, 80 CHI.-KENT L. REV. 641 (2005).

23. See PAUL G. HASKELL, PREFACE TO WILLS, TRUSTS AND ADMINISTRATION 77 (2d ed. 1994) (explaining that the vast majority of trusts are created by the execution of a formal written instrument).

24. RESTATEMENT (THIRD) OF TRUSTS § 2 (2003).

25. RESTATEMENT (SECOND) OF TRUSTS § 170(1) (1957); FREMONT-SMITH, *supra* note 11, at 187 (“The duty of a fiduciary is, in essence, a duty of loyalty.”).

26. RESTATEMENT (SECOND) OF TRUSTS § 174 (1957).

27. See RESTATEMENT (THIRD) OF TRUSTS § 28 cmt. a (2003).

28. See RESTATEMENT (SECOND) OF TRUSTS § 348 cmt. f (1957):

Where property is given to a charitable corporation, particularly where restrictions are imposed by the donor, it is sometimes said by the courts that a charitable trust is created and that the corporation is a trustee. It is sometimes said, however, that a charitable trust is not created. This is a mere matter of terminology. The important question is whether and to what extent the principles and rules applicable to charitable trusts are applicable to charitable corporations.

Ordinarily the principles and rules applicable to charitable trusts are applicable to charitable corporations. . . .

tity that is restricted “to a single purpose within the range of purposes authorized by” the corporation’s articles of incorporation.²⁹

Most U.S. charities are organized as nonprofit corporations,³⁰ and most of these are governed by boards of directors that select their own successors (“self-perpetuating” boards).³¹ One creates a nonprofit corporation by delivering articles of incorporation to the office of the secretary of state,³² and a corporation’s legal existence commences with that office’s filing of those articles.³³ A charity’s articles specify that it is a charitable or “public benefit” corporation³⁴ and that on dissolution its assets will be distributed to another charitable undertaking.³⁵ These articles can also state the specific charitable purpose for which the corporation is being formed,³⁶ but some jurisdictions do not even require this.³⁷

B. *Default Rules for Mission Change in Charitable Organizations*

Unless a trust’s terms expand the trustees’ discretion, trust law requires trustees to advance a settlor’s specific charitable purposes for as long as these can be advanced.³⁸ This duty applies unless settlor’s purposes have been fulfilled³⁹ or frustrated (i.e., have become unlawful, impossible, or impracticable to carry out).⁴⁰ When that occurs, the default rule permits the

29. George G. Triantis, *Organizations as Internal Capital Markets: The Legal Boundaries of Firms, Collateral, and Trusts in Commercial and Charitable Enterprises*, 117 HARV. L. REV. 1102, 1151 (2004). A donor creates a trust, for example, by donating money to a nonprofit hospital corporation to support research on a particular disease or to establish an alcoholism treatment center. See RESTATEMENT (THIRD) OF TRUSTS § 28 cmt. a (2003) (explaining that a donation to a charitable institution for a specific purpose “creates a charitable trust of which the institution is the trustee for purposes of the terminology and rules of this Restatement”); cf. REVISED MODEL NONPROFIT CORP. ACT § 8.30(e) & cmt. 1 (1987) (providing that if a charitable corporation holds property in trust, its directors are not deemed to be trustees with respect to such property).

30. JAMES J. FISHMAN & STEPHEN SCHWARZ, *NONPROFIT ORGANIZATIONS: CASES AND MATERIALS* 63 (2d ed. 2000).

31. FREMONT-SMITH, *supra* note 11, at 159.

32. See, e.g., REVISED MODEL NONPROFIT CORP. ACT § 2.01 (1987).

33. *Id.* § 2.03(a).

34. See, e.g., *id.* § 2.02(a)(2)(i).

35. See, e.g., *id.* §§ 2.02(a)(6), 14.06(a)(6).

36. See, e.g., *id.* § 2.02(a)(2)(i), (b)(1).

37. See, e.g., IND. CODE ANN. § 23-17-3-3(1) (West 2005) (nonprofit’s articles of incorporation may state the purpose(s) for which the corporation is organized, but is not required); REVISED MODEL NONPROFIT CORP. ACT § 2.02(b)(1) (1987).

38. See RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE § 379 cmt. a (1990) (explaining the trustee is obliged “to administer [the trust] solely in the interest of effectuating the charitable purposes”).

39. RESTATEMENT (SECOND) OF TRUSTS § 400 (1957).

40. *Id.* § 399. The Restatement (Third) of Trusts also would apply cy pres to that portion of the trust’s property that is “wasteful to apply . . . to the [settlor’s] designated purpose.” RESTATEMENT (THIRD) OF TRUSTS § 67 (2003). However, this proposition is controversial. See Robert A. Katz, *A Pig*

courts to apply the trust's unexpended property "to a charitable purpose that reasonably approximates the [original] designated purpose,"⁴¹ "unless the terms of the trust . . . express a contrary intention."⁴² This is known as the doctrine of "cy pres," from the Anglo-French term for "as near."⁴³

As compared to charitable trustees, a charitable corporation's board of directors has more discretion over its charity's mission and assets, except for restricted gifts, which are held in trust.⁴⁴ This is in keeping with the modern trend to pattern nonprofit corporate law after the law of for-profit or business corporations.⁴⁵ This policy—once referred to as corporate law "parallelism"⁴⁶—applies to both matters of form *and* of substance. For example, most states that have addressed the issue subject directors of charitable corporations ("charitable directors") to the fiduciary duties applicable to directors of business corporations under business corporation law, which are more lenient than the fiduciary duties applicable to trustees under trust law.⁴⁷

Business corporation statutes typically authorize the board of directors to "set[] the course of the enterprise by determining the company's general objectives, goals, and philosophies"⁴⁸ and also "to adopt, amend, and repeal bylaws."⁴⁹ Under corporate law parallelism, charitable directors have all this authority and more. The directors of a business corporation cannot fundamentally change the corporation's charter or organization without shareholder approval.⁵⁰ Yet a nonmembership charitable corporation lacks

in a Python: How the Charitable Response to September 11 Overwhelmed the Law of Disaster Relief, 36 IND. L. REV. 251, 272–81 (2003) (discussing how charity law deals with alleged surplus funds for disaster relief); Comment, *Cy Pres Inexpediency and the Buck Trust*, 20 U.S.F. L. REV. 577, 691 (1986) (discussing litigation involving alleged surplus funds and petition for cy pres expansion of purpose).

41. RESTATEMENT (THIRD) OF TRUSTS § 67 (2003). Traditionally, cy pres would not apply unless "the settlor manifested a more general intention to devote the property to charitable purposes." RESTATEMENT (SECOND) OF TRUSTS § 399 (1957).

42. RESTATEMENT (THIRD) OF TRUSTS § 67 cmt. *b* (2003).

43. HASKELL, *supra* note 23, at 262 (citation omitted).

44. *See, e.g.*, RESTATEMENT (THIRD) OF TRUSTS § 28 cmt. *a* (2003); REVISED MODEL NONPROFIT CORP. ACT § 11.07 cmt. (1987) ("A provision in a will or other instrument requiring that a bequest or gift be used for a specified purpose is not negated by a [donee nonprofit corporation's] merger [with another corporation]. . . . [The surviving corporation] can only use the property for the specified purposes."). However, even if a nonprofit corporation is deemed to hold property in trust, the directors are not deemed to be trustees with respect to such property. *See, e.g., id.* § 8.30(e) & cmt. 1.

45. *See supra* note 11.

46. *See supra* note 10.

47. FREMONT-SMITH, *supra* note 11, at 200; *see* REVISED MODEL NONPROFIT CORP. ACT § 8.30(a)(1), (3) (1987) (stating directors' duty of loyalty obliges them to act in good faith in a manner they reasonably believe to be in the best interests of the corporation).

48. COX ET AL., *supra* note 12, at 154.

49. *Id.* at 155–56.

50. *Id.* at 155.

either shareholders or an electorate entitled to vote for board members or give them the boot. Rather, a majority of directors typically suffices to change the articles of incorporation,⁵¹ unless the articles or bylaws impose additional requirements.⁵² Such authority presumably extends to the articles' statement of purposes.⁵³ Indeed, where corporate law parallelism prevails, there seems to be no intrinsic limit on the board's ability to alter the corporation's charitable purposes, so long as the requisite procedures are followed.⁵⁴ This approach also gives the board plenary authority to redirect the corporation's general funds (i.e., all funds other than restricted gifts) to the amended purposes.⁵⁵

This expansive view of the board's authority finds indirect support in the Revised Model Nonprofit Corporation Act (the "Act"), a leading statement of corporate law parallelism. The Act nowhere suggests an articles' statement of purposes cannot be amended.⁵⁶ Although the Act recognizes the trust-like nature of restricted gifts,⁵⁷ it nowhere requires the use of general funds for pre-amendment purposes only. The Act's restrictions on self-

51. See, e.g., REVISED MODEL NONPROFIT CORP. ACT § 10.02(b) (1987).

52. See, e.g., *id.* § 10.30 ("The articles may require an amendment to the articles or by-laws to be approved in writing by a specified person or persons other than the board.")

53. See, e.g., *United Methodist Church, Inc. v. Bethany Med. Ctr., Inc.*, 969 P.2d 859, 863–65 (Kan. 1998) (holding that district court violated due process by permanently enjoining a charitable corporation's board from amending its articles of incorporation to change the plan for distributing its assets on dissolution); *Attorney General v. Hahnemann Hosp.*, 494 N.E.2d 1011, 1020–21 (Mass. 1986) (recognizing a nonprofit corporation's board's authority to amend its articles of incorporation to alter its mission); see also REVISED MODEL NONPROFIT CORP. ACT § 10.01 (1987) ("A corporation may amend its articles of incorporation at any time to add or change a provision that is required or permitted in the articles or to delete a provision not required in the articles."); *id.* § 10.02(b); Thomas L. Greaney & Kathleen M. Boozang, *Mission, Margin, and Trust in the Nonprofit Healthcare Enterprise*, 5 YALE J. HEALTH POL'Y & L. 1, 56 n.205 (2005) ("It has long been assumed that a board may alter its mission by amending its articles of incorporation.")

54. See, e.g., *Hahnemann Hosp.*, 494 N.E.2d at 1020 (dictum) (explaining that a nonprofit corporation could change its purposes, even if such amendments do not further the corporation's "dominant charitable purpose," where the state nonprofit corporation statute does not explicitly limit a nonprofit corporation's powers of amendment).

55. See, e.g., *FREMONT-SMITH*, *supra* note 11, at 440. Fremont-Smith discussed a case where: the court applied general corporate law principles under which the directors are virtually unrestricted in their ability to direct disposition of the general funds of the corporation [i.e., all funds except restricted gifts], whether they are amending its charitable purposes or selling its assets and directing disposition of the proceeds.

Id. (citing *Banner Health Sys. v. Long*, 663 N.W.2d 242 (S.D. 2003); *Banner Health System v. Stenehjelm*, No. A3-02-121, 2003 WL 501821 (D.N.D. 2003)); *cf. Hahnemann Hosp.*, 494 N.E.2d at 1021 (dictum) (commenting that a charitable corporation that amends its articles lacks unfettered discretion to devote pre-amendment funds to new charitable purposes that are not similar or are even contradictory to its prior charitable purposes).

56. Greaney & Boozang, *supra* note 53, at 56 n.205.

57. REVISED MODEL NONPROFIT CORP. ACT § 11.07 cmt. (1987) ("A provision in a will or other instrument requiring that a bequest or gift be used for a specified purpose is not negated by a [donee nonprofit corporation's] merger [with another corporation.] . . . [The surviving corporation] can only use the property for the specified purposes.")

dealing do not change matters, notwithstanding the Reporter's claim that these "will help [assure] potential donors that their contributions [(1)] *will be dedicated to the corporation's public purposes* and [(2)] will not be used for private gain of the corporation's members or managers."⁵⁸ Yet the text only bears out the second assertion: self-dealing restrictions may deter the use of donations for noncharitable ends, but they do not compel directors to use donations for any particular charitable purpose.⁵⁹

II. PROMOTING MISSION ACCOUNTABILITY IN CHARITABLE CORPORATIONS THROUGH TRUST LAW PARALLELISM

Corporate law parallelism has its critics. The application of for-profit corporate law to charitable corporations, assert Professors Greaney and Boozang, "has never adequately addressed the accountability void that results from charitable corporations' lack of shareholders and market for corporate control."⁶⁰ In an attempt to fill this void, some commentators and officials advocate using trust law principles to curb board discretion. This project is complicated by the fact that the settlor of a charitable trust is typically both its founder as well as its funder, whereas in charitable corporations different parties typically play these roles. Trust law parallelism's doctrinal agenda is thus two-fold. The first component—the duty of obedience—would tether the board more tightly to the corporation's original (i.e., the founder's chosen) charitable purposes. The second component—the charitable trust doctrine—would curb a corporation's ability to apply unrestricted donations to newly adopted purposes.

Although these two doctrines are distinguishable conceptually, they often lead to the same result. On several occasions, these principles have been employed (even simultaneously, but not always by name, and not always successfully) to challenge a corporate board's efforts to redirect a corporation's focus and assets. Most of these instances involved nonprofit health care corporations, including hospitals wanting to lease or sell their main facilities in order to run outpatient clinics;⁶¹ a multistate healthcare

58. *Id.* at xxvi (emphasis added) (citing *id.* § 8.31(b)).

59. This is true of the nondistribution constraint more generally. See HENRY HANSMANN, *THE OWNERSHIP OF ENTERPRISE* 235 (1996) ("The nonprofit form is a very crude consumer protection device. It does not create strong positive incentives for [a nonprofit's fiduciaries to] serv[e] customers well; it simply reduces the incentives to serve them poorly.").

60. Greaney & Boozang, *supra* note 53, at 2 (citations omitted).

61. See, e.g., *In re Manhattan Eye, Ear & Throat Hosp.*, 715 N.Y.S.2d 575, 592 (N.Y. Sup. Ct. 1999) (holding "the purposes of the corporation will be promoted by the sale of . . . the hospital's assets") (quotation omitted); *Queen of Angels Hosp. v. Younger*, 136 Cal. Rptr. 36, 41 (Cal. Ct. App. 1977) (holding hospital "cannot, consistent with the trust imposed upon it, abandon the operation of the hospital business in favor of clinics").

system selling its facilities in some locations in order to consolidate its operations elsewhere;⁶² and non-Catholic hospitals seeking to merge with Catholic hospitals, where doing so would curtail the provision of abortions and other reproductive services.⁶³

A. Duty of Obedience

Several commentators have asserted that directors of charitable corporations have a unique fiduciary duty⁶⁴ to be faithful to their organization's mission.⁶⁵ In its mildest formulation, the duty of obedience puts a nonprofit spin on the principle that a corporation should not engage in *ultra vires* acts (i.e., acts "beyond the scope of power allowed or granted by a corporate charter").⁶⁶ In the nonprofit context, *ultra vires* prohibits a charitable corporation from advancing charitable purposes other than those set forth in its articles of incorporation.⁶⁷ Courts can enjoin a charitable corporation from engaging in *ultra vires* transactions and can hold directors liable for engaging in them.⁶⁸

In addition to this negative command—do not advance purposes the charity is not authorized to advance—the duty of obedience has a positive component: directors should actively "carry out the mandates of the indenture under which they operate."⁶⁹ Just as a for-profit board should aim to maximize shareholder value, so too should a charitable board aim to maximize the fulfillment of the organization's mission⁷⁰ and perhaps also aim to

62. See *Banner Health Sys. v. Long*, 663 N.W.2d 242, 248–49 (S.D. 2003) (holding that there are legal theories that would permit the imposition of a charitable trust on the general assets of a nonprofit health care corporation selling its assets within South Dakota).

63. See, e.g., Alison Manolovici Cody, *Success in New Jersey: Using the Charitable Trust Doctrine to Preserve Women's Reproductive Services When Hospitals Become Catholic*, 57 N.Y.U. ANN. SURV. AM. L. 323, 323–27 (2000); N.H. ATTORNEY GEN., REPORT ON OPTIMA HEALTH § III (Mar. 10, 1998), available at <http://doj.nh.gov/publications/optima1.html>.

64. That is, in addition to the standard corporate law duties of loyalty and care.

65. FISHMAN & SCHWARZ, *supra* note 30, at 227–29; KURTZ, *supra* note 17, at 21; Peggy Sasso, *Searching for Trust in the Not-For-Profit Boardroom: Looking Beyond the Duty of Obedience to Ensure Accountability*, 50 UCLA L. REV. 1485, 1530 (2003) (arguing that higher duty standard should be applicable to not-for-profit directors).

66. BLACK'S LAW DICTIONARY 1559 (8th ed. 2004) (defining "ultra vires").

67. Rob Atkinson, *Unsettled Standing: Who (Else) Should Enforce the Duties of Charitable Fiduciaries?*, 23 J. CORP. L. 655, 661 (1998) ("[T]he uses to which charitable fiduciaries may properly put assets entrusted to them are said to be constrained, not only by the outer limits of charity, but also by specific purpose provisions in the charity's organizational documents . . .").

68. *Id.*

69. KURTZ, *supra* note 17, at 84 (quoting *Pennsylvania v. Barnes Found.*, 159 A.2d 500, 505 (Pa. 1960)).

70. Sasso, *supra* note 65, at 1528 (analogizing that the nonprofit director's duty to advance the charitable mission is "roughly equivalent" to the for-profit director's duty to increase shareholder value).

maximize the satisfaction (or “philanthropic returns”) of those who have invested their time, money, and energy into the enterprise.⁷¹

As presented above, the milder version of the duty of obedience speaks only to the charitable purposes for which the corporation is currently organized to advance—i.e., those set forth in a corporation’s articles of incorporation. It does not bar the board from altering these purposes, so long as (at a minimum) the requisite procedures are followed.⁷² The most robust version of the duty, by contrast, expects boards to adhere to the corporation’s original purposes absent a determination that these purposes have failed (e.g., they have become impossible, illegal, or impracticable to pursue).⁷³ This accords with Kurtz’s description of the duty as akin to a trustee’s duty to “administer[] a trust in a manner faithful to the expressed wishes of the creator.”⁷⁴ Fidelity to a charity’s original purposes, states Professor David H. Smith, can be “personalized as identification with the particular objectives of the [corporation’s] donor or founders.”⁷⁵ In this vein, Professor Atkinson describes fidelity to the original mission as “the charitable equivalent of ‘Honor thy father and thy mother,’ with the organization’s founders and donors standing in *loco parentis*.”⁷⁶

In 1999, a New York trial court accepted the most robust version of the duty of obedience in *Matter of Manhattan Eye, Ear & Throat Hospital v. Spitzer*.⁷⁷ After losing patients and revenues for many years, the Manhattan Eye, Ear & Throat Hospital (“MEETH”) planned to sell its main facility and use the proceeds, most notably, to operate freestanding clinics in underserved neighborhoods.⁷⁸ A state trial court refused to approve this plan,

71. Triantis, *supra* note 29, at 1145 (“Whereas an investor in the commercial sector seeks a financial return, the charitable donor often pursues a philanthropic return in the improved welfare of others.”) (citation omitted).

72. See, e.g., Reiser, *supra* note 7, at 215 (“Nonprofit organizations . . . must abide by their original missions or use legitimate means to transform those missions over time.”).

73. See, e.g., KURTZ, *supra* note 17, at 85 (“Unless allowed by law, nonprofit directors may not deviate in any substantial way from the duty to fulfill the particular purposes for which the organization was created.”); *In re Manhattan Eye, Ear & Throat Hosp.*, 715 N.Y.S.2d 575, 597 (N.Y. Sup. Ct. 1999) (requiring “reasoned determination” that nonprofit cannot continue to operate toward fulfilling its mission before approving sale of assets); cf. ALI, Nonprofit Law, Council Draft No. 1, *supra* note 2, § 240(c)(1) (providing that a charitable corporation may change its charitable purpose to another charitable purpose without a determination by its governing board “that the current purpose of the charity has failed”).

74. KURTZ, *supra* note 17, at 85 (citations omitted).

75. DAVID H. SMITH, ENTRUSTED: THE MORAL RESPONSIBILITIES OF TRUSTEESHIP 5 (1995).

76. Atkinson, *supra* note 67, at 661.

77. *Manhattan Eye, Ear & Throat Hosp.*, 715 N.Y.S.2d at 592–95; see ALI, Nonprofit Law, Council Draft No. 1, *supra* note 2, § 240 rptr’s note 10 (“This duty [of obedience] was accepted in *Matter of Manhattan Eye, Ear & Throat Hospital v. Spitzer* . . .”).

78. *Manhattan Eye, Ear & Throat Hosp.*, 715 N.Y.S.2d at 576. MEETH submitted its petition pursuant to New York’s not-for-profit corporation law § 511. N.Y. NOT-FOR-PROFIT CORP. LAW

and this decision turned on its understanding and application of the duty of obedience. The court declared:

[T]he duty of obedience . . . mandates that a [charitable corporation's] Board, in the first instance, seek to preserve its original mission. Embarkation upon a course of conduct which turns it away from the charity's central and well-understood mission should be a carefully chosen option of last resort. Otherwise, a Board facing difficult financial straits might find sale of its assets, and "reprioritization" of its mission, to be an attractive option, rather than taking all reasonable efforts to preserve the mission which had been the object of its stewardship.⁷⁹

MEETH's board breached its duty of obedience, the court found, because it failed to make "a reasoned and studied determination . . . that the financial difficulties [it faced] made it *impossible* to ensure the survival of MEETH."⁸⁰

As the MEETH decision demonstrates, the most robust version of the duty of obedience effectively requires a board to advance the corporate mission for as long as that is possible (within reason). Directors cannot fundamentally alter a corporation's charitable purpose simply because they believe that their efforts and the entity's resources could serve more socially valuable ends.

B. *The Charitable Trust Doctrine*

Naturally enough, the law imposes more restrictions on a charitable corporation's use of restricted gifts (i.e., gifts that expressly limit their use to specific purposes) than unrestricted gifts (i.e., outright gifts with no express restrictions on their use). A restricted gift creates a charitable trust or its functional equivalent,⁸¹ and the donee is obliged to honor these restrictions even if it later changes its charitable purposes.⁸² By contrast, an unrestricted gift does not create a formal "trust" within the meaning of trust law,⁸³ and the donee can use it for any charitable purpose set forth in its

§ 511(d) (McKinney 2005) (a court may authorize the sale of all or substantially all the assets of a nonmembership charitable corporation "[i]f it shall appear, to the satisfaction of the court . . . that the purposes of the corporation . . . will be promoted" by the transaction).

79. *Manhattan Eye, Ear & Throat Hosp.*, 715 N.Y.S.2d at 595 (emphases added).

80. *Id.* (emphasis added).

81. *Supra* note 44.

82. *See, e.g.*, REVISED MODEL NONPROFIT CORP. ACT § 11.07 cmt. (1987) ("A provision in a will or other instrument requiring that a bequest or gift be used for a specified purpose is not negated by a [donee nonprofit corporation's] merger [with another corporation.] . . . [The surviving corporation] can only use the property for the specified purposes.").

83. *See, e.g.*, RESTATEMENT (THIRD) OF TRUSTS § 28 cmt. *a* (2003) ("An outright devise or donation to a nonproprietary hospital or university or other charitable institution, expressly or impliedly to be used for its general purposes, is charitable but does not create a trust as that term is used in this Restatement.").

articles of incorporation. Critically, a charitable corporation can use unrestricted gifts (as well as nondonated assets) for any charitable purpose it subsequently adopts by amending its articles.⁸⁴

The “charitable trust doctrine”—another instance of trust law parallelism in action—seeks to erase the legal distinction between restricted and unrestricted gifts and also seeks to extend the realm of trust law to reach a charitable corporation’s unrestricted gifts. More specifically, the doctrine requires that, when a charitable corporation changes its charitable purposes by amending its articles of incorporation, the unrestricted gifts the donee received prior to the amendment can be used only for its pre-amendment charitable purposes. Presumably, these assets could be redeployed if the pre-amendment purposes had failed (i.e., had become illegal, impossible, or impracticable to advance).⁸⁵ The pre-amendment charitable purposes are determined in the first instance by the donee’s articles of incorporation.⁸⁶ These purposes also can be deduced from the way the donee actually has operated⁸⁷ (i.e., what have been its dominant activities⁸⁸), representations made to tax authorities, and representations made to the public when soliciting donations.⁸⁹

The most expansive version of the charitable trust doctrine would restrict a charitable corporation’s use of pre-amendment, nondonated assets (e.g., user fees) to pre-amendment purposes only. This is justified on grounds that the corporation’s nondonated assets are inextricably connected to the donated assets in two ways: first, “because it is [allegedly] impossible to separate out [unrestricted gifts] from non-donated assets, all assets must be treated as subject to a trust;”⁹⁰ and second, the donated assets were

84. This is the position taken by the first council draft of the ALI’s Principles of the Law of Nonprofit Organizations. ALI, Nonprofit Law, Council Draft No. 1, *supra* note 2, § 245(b).

85. Michael W. Peregrine, *Charitable Trust Laws and the Evolving Nature of the Nonprofit Hospital Corporation*, 30 J. HEALTH & HOSP. L. 11, 12 (1997).

86. *See, e.g.*, *Pacific Home v. Los Angeles County*, 264 P.2d 539, 543 (Cal. 1953) (providing that, where a charitable corporation organized for a specific charitable purpose accepts assets, this “establishes a charitable trust for the declared corporate purposes as effectively as though the assets had been accepted from a donor who had expressly provided in the instrument evidencing the gift that it was to be held in trust solely for such charitable purposes”). *Cf.* Greaney & Boozang, *supra* note 53, at 66 (questioning whether pre-Revised Model Nonprofit Corporations Act cases that impose a trust on unrestricted gifts to charitable corporations remain good law in California).

87. *Queen of Angels Hosp. v. Younger*, 136 Cal. Rptr. 36, 39 (Cal. Ct. App. 1977).

88. Peregrine, *supra* note 85, at 13.

89. *Queen of Angels Hosp.*, 138 Cal. Rptr. at 41.

90. Greaney & Boozang, *supra* note 53, at 69 (citations omitted). *See generally id.* at 66–72 (surveying and critiquing arguments in favor of imposing a charitable trust on the entire assets of a charitable corporation).

the “base capital” that enabled the corporation to acquire its nondonated assets.⁹¹

III. MISSION ACCOUNTABILITY IN TRUSTS: AN AGENCY THEORY ANALYSIS

To address the perceived deficit of nonprofit mission accountability, some nonprofit commentators and regulators propose applying charitable trust law principles to charitable corporations. In many organizational contexts, agency theory provides a useful tool for framing and exploring accountability issues. This section lays the groundwork for assessing “trust law parallelism” from an agency perspective. It does so by providing a primer on agency theory, discussing Professor Robert Sitkoff’s illuminating use of agency theory to analyze the law of private donative trusts,⁹² and considering its implications for the law of charitable trusts.

A. *An Agency Theory Primer*

Economic agency theory (as distinguished from agency law⁹³) studies relationships in which one party, a “principal,” benefits when another party, an “agent,” performs a certain task with care or effort.⁹⁴ Agency relationships are problematic insofar as the interests of the parties diverge and there is an information asymmetry between them, which prevents the principal from verifying whether the agent pursues the principal’s interests rather than his own.⁹⁵ The arrangement gives rise to at least two types of costs (a.k.a. “agency costs”): monitoring costs and residual loss of welfare.⁹⁶ The “monitoring costs” are the expenditures on devices to ensure

91. Patrick Coffey et al., *The “Charitable Trust” Controversy Confronting Banner Health and Other Nonprofit Healthcare Systems*, 16 HEALTH LAW. 1, 4 (2003).

92. See generally Robert H. Sitkoff, *An Agency Costs Theory of Trust Law*, 89 CORNELL L. REV. 621 (2004).

93. Under agency law, a legal agency relationship requires the ongoing existence of a principal under whose control the agent acts. RESTATEMENT (SECOND) OF AGENCY § 1 (1957); Restatement (Third) of Agency § 1.01 & cmt. c (Tentative Draft No. 2, 2001). In contrast, economic agency relationships require neither a principal nor an agent, although the agency costs that accompany such relationships are undoubtedly lower when these requirements are met.

94. Eric A. Posner, *Agency Models in Law and Economics*, in CHICAGO LECTURES IN LAW AND ECONOMICS 225, 225 (Eric A. Posner ed., 2000). Such relationships typically are described using the metaphor of a contract between the principal and agent. Kathleen M. Eisenhardt, *Agency Theory: An Assessment and Review*, 14 ACAD. MGMT. REV. 57, 58 (1989).

95. *Id.*

96. HANSMANN, *supra* note 59, at 304 n.2 (noting that some scholars posit a third element of agency costs known as “bonding” costs, which refers to the costly measures the agent incurs to assure the principal of his good behavior and fidelity to her interest, as well as to compensate the principal for his misbehavior); see, e.g., Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial*

that the agent does the principal's bidding. These include monitoring the agent's activities more closely, measuring his output, and providing him with special incentives to align his interests more closely to hers. The "residual loss" consists of the principal's loss of utility or welfare due to the agent's opportunistic pursuit of his own interests at her expense, notwithstanding the effect monitoring expenditures have. Whatever the principal does (or does not do), she will experience some residual loss, incur monitoring costs, or both: her agency costs thus always will be greater than zero. This dilemma is known as an "agency problem." The agency perspective invites us to consider measures to limit the agent's self-serving behavior in a cost-effective manner, and thereby minimize the agency costs inherent in this relationship.⁹⁷

The agency model often is applied to the relationship between the shareholders (principals) of a publicly traded, for-profit corporation and its salaried corporate executives (agents), whom the shareholders hire to run the firm in the shareholders' best interests.⁹⁸ This application can be quite fruitful because we can state with relative certainty that what the typical shareholder wants is to realize profit (capital gains) by selling the stock for more than what she paid for it. Likewise, it is relatively clear what the shareholder wants the corporate executives to do for her: to act in a manner that increases the stock's price. An agency problem arises because salaried corporate executives, whose activities cause the price of stock to rise, receive only a fraction of the wealth (capital gains) they generate for shareholders. Such executives thus have less incentive than shareholders to cause the stock price to rise. The measurable nature of a shareholder's interest, however, makes it easier to monitor the executives' performance, most notably, by ascertaining the firm's stock price. As a result, the shareholders' agency problem and attendant costs vis-à-vis corporate executives tend to be tractable.

In this context, the concept of "accountability" can be usefully framed and analyzed using the tools of economic agency theory. Many corporate

Behavior, Agency Costs and Ownership Structure, 3 J. FIN. ECON. 305, 308 (1976) (summarizing unavoidable transaction costs of agency relationship); STEPHEN M. BAINBRIDGE, *CORPORATION LAW AND ECONOMICS* 35–36 (2002) (defining agency costs as including monitoring and bonding costs) (citation omitted). Professor Hansmann sees bonding expenditures as a social cost of monitoring the agents. HANSMANN, *supra* note 59, at 304 n.2. For convenience, I will not discuss these.

97. Eisenhardt, *supra* note 94, at 59.

98. Chris Cornforth, *Introduction: The Changing Context of Governance—Emerging Issues and Paradoxes*, in *THE GOVERNANCE OF PUBLIC AND NON-PROFIT ORGANIZATIONS: WHAT DO BOARDS DO?* 1, 7 (Chris Cornforth ed., 2003) (explaining agency theory "has been the dominant theory of the [business] corporation and corporate governance arrangements") (citation omitted); Eisenhardt, *supra* note 94, at 59 (referring to several articles on minimizing agency costs via different mechanisms).

law scholars argue that as a normative matter, corporate law should aim to reduce the agency costs inherent in the shareholder-director relationship⁹⁹ and in this way make directors more accountable to shareholders.¹⁰⁰ The standard duties of loyalty and care help advance this goal,¹⁰¹ as do the shareholders' right to elect the directors and bring derivative suits.¹⁰² Even in the absence of shareholder action, the markets for capital and corporate control induce directors to act in ways that benefit shareholders and punish those who do not.¹⁰³

B. *An Agency Costs Theory of Private Donative Trusts*

In Sitkoff's view, the private trust can be seen as the site of two key principal-agent relationships: settlor-trustee and beneficiary-trustee. In the archetypical donative trust, a settlor (principal #1) engages a trustee (qua settlor's agent) to manage a portfolio of assets in the best interests of the beneficiaries, subject to the settlor's instructions as set forth in the trust instrument.¹⁰⁴ This arrangement triggers an agency problem: will the trustee "remain loyal to the settlor's original wishes," or will he "slight or ignore what [the settlor] would have wanted[?]"¹⁰⁵ Sitkoff describes this relationship as "temporal,"¹⁰⁶ although a more precise characterization might be "noncontemporaneous" in that the settlor may be deceased or otherwise absent for at least some time period covered by their relationship.¹⁰⁷ For example, if a settlor creates a testamentary trust, the agency relationship does not commence until after the settlor's death.

Insofar as the beneficiaries gain as a result of the trustee's activities, they function as a second principal (principal #2)—albeit a derivative one—to the trustee (qua beneficiaries' agent). This arrangement triggers

99. See, e.g., BAINBRIDGE, *supra* note 96, at 207 ("[M]uch of corporate law is best understood as a mechanism for constraining these agency costs [in the shareholder-manager relationship].").

100. Evelyn Brody, *Agents Without Principals: The Economic Convergence of the Nonprofit and For-Profit Organizational Forms*, 40 N.Y.L. SCH. L. REV. 457, 465 (1996) ("In a business firm, 'accountability' is the mechanism by which the corporate board and management (the 'agents') answer to the shareholders (the 'principal').").

101. See, e.g., Daniel R. Fischel & Michael Bradley, *The Role of Liability Rules and the Derivative Suit in Corporate Law: A Theoretical and Empirical Analysis*, 71 CORNELL L. REV. 261, 261–83, 290–91 (1986).

102. BAINBRIDGE, *supra* note 96, at 37.

103. See, e.g., Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 112–14 (1965); BAINBRIDGE, *supra* note 96, at 37, 207.

104. See Sitkoff, *supra* note 92, at 624.

105. *Id.* at 621, 624.

106. *Id.* at 621.

107. WEBSTER'S NEW WORLD COLLEGE DICTIONARY 314 (4th ed. 1999) (defining "contemporaneous" as "existing or happening in the same period of time").

the “usual” agency problem that arises when one party (here the trustee) manages assets while another party (here the beneficiaries) bears the risks and marginal costs (as well as the benefits) of the first party’s managerial decisions.¹⁰⁸ In this case, the issue is “whether the trustee-manager will act in the best interests of the beneficiaries.”¹⁰⁹ This dual set of agency problems makes the trust distinctive. “[T]he core insight that animates the agency costs analysis” of the private trust, claims Sitkoff, is “[t]hat [the settlor] saddled her transfer [of property] to [the beneficiaries] with the friction of competing principal-agent relationships.”¹¹⁰ The for-profit corporate form, by contrast, “presents one dominant source of agency costs,” namely, “the shareholder/manager relationship.”¹¹¹

The trustee’s task may be uncomfortable because settlor and beneficiaries may have divergent interests and preferences.¹¹² The settlor could have made an outright gift to the beneficiaries for them to use as they please, but she chose not to do so. Her decision can be explained in a number of ways. One can describe the settlor as altruistic but paternalistic. She is altruistic because she derives satisfaction from increases to the beneficiaries’ well-being, i.e., her utility function includes the beneficiaries’ utility as one of its components. Yet she also has a “(paternalistic) view of the beneficiaries’ expected utility” and so does not (wholly) defer to the beneficiaries’ view of their own utility.¹¹³ Alternatively, one can describe the settlor as an “impure” altruist. The purely altruistic donor, according to Professor Eric Posner, cares about the donee’s welfare or utility, whereas the impure altruist cares about the donee’s consumption.¹¹⁴ The pure altruist is more inclined to make an outright gift: by maximizing the donee’s subjective utility, she thereby maximizes her own. The parties’ interests are thus perfectly aligned. The impure altruist, by contrast, gains utility by altering the donee’s consumption of goods or services in ways that likely increase but do not maximize the donee’s utility.¹¹⁵ Either account of the settlor’s utility function explains why “parents often pay a child’s tuition

108. Sitkoff, *supra* note 92, at 658.

109. *Id.* at 683. Sitkoff describes the beneficiaries as the trust’s “residual claimants” insofar as they “are limited to taking so much as the trust instrument allows out of whatever is left of the trust’s assets when all other claims are settled.” *Id.* at 646–47.

110. *Id.* at 624.

111. *Id.*

112. *Id.*

113. *Id.* at 649 n.136.

114. Eric A. Posner, *Altruism, Status, and Trust in the Law of Gifts and Gratuitous Promises*, 1997 WIS. L. REV. 567, 573.

115. Robert A. Katz, *Can Principal-Agent Models Help Explain Charitable Gifts and Organizations?*, 2000 WIS. L. REV. 1, 10, 15.

rather than giving him cash which the child may squander,” or why “[a] Good Samaritan may offer food or clothing to a poor person, rather than money, for fear the recipient would use the money to purchase drugs.”¹¹⁶

The settlor’s and beneficiaries’ divergent interests may force the trustee to choose between: (a) altering the beneficiaries’ consumption—and presumably increasing their utility—according to the settlor’s design; or (b) maximizing the beneficiaries’ utility according to their own likings. Sitkoff’s normative claim is that trust law should favor the former. More precisely, trust law should aim to maximize the beneficiaries’ welfare,¹¹⁷ “but only to the extent that doing so is consistent with the ex ante instructions of the settlor.”¹¹⁸ In other words, trust law should recognize the settlor as the trust’s (and trustee’s) “primary” or “dominant” principal.¹¹⁹

Sitkoff points to trust law’s *Clafin* doctrine as an example of settlor primacy in action. This doctrine holds that absent the settlor’s consent (including trust terms to that effect)¹²⁰ a trust may not be terminated or modified if doing so “would be inconsistent with a material purpose of the trust,” even if all of the beneficiaries consent to the proposed termination or modification.¹²¹ The *Clafin* doctrine’s “dominant idea,” states one hornbook, “is the fulfillment of the settlor’s wishes.”¹²² Its practical effect, according to Sitkoff, is that “unless the trustee consents, American trusts are difficult to amend or terminate once established.”¹²³ As a result, the trustee has more leeway “to preserve the settlor’s original design, regardless of the beneficiaries’ wishes, which is what the settlor likely would have wanted.”¹²⁴ In this way, he concludes, the doctrine “helps align the interests of the settlor and the trustee,”¹²⁵ thereby mitigating the settlor’s agency problem vis-à-vis the trustee.

Sitkoff claims that settlor primacy in private trust law will make both settlors and beneficiaries better off and in this way increase social

116. Posner, *supra* note 114, at 573.

117. Sitkoff, *supra* note 92, at 669.

118. *Id.* at 621.

119. *Id.* at 683–84; *see id.* at 644, 669 (discussion of settlor as the trust’s “dominant principal”).

120. The *Clafin* doctrine is a nonmandatory default rule so that the trust instrument can authorize beneficiaries to terminate the trust prematurely. *Id.* at 663.

121. RESTATEMENT (THIRD) OF TRUSTS § 65(2) (2003) (citing *Clafin v. Clafin*, 20 N.E. 454, 455 (Mass. 1889)).

122. WILLIAM M. MCGOVERN, JR. & SHELDON F. KURTZ, *WILLS, TRUSTS AND ESTATES: INCLUDING TAXATION AND FUTURE INTERESTS* § 9.6 (2d ed. 2001).

123. Sitkoff, *supra* note 92, at 659 (citation omitted).

124. *Id.*

125. *Id.*

wealth.¹²⁶ This claim reasonably assumes: (a) by increasing the confidence of grantors that their trust instructions will be followed, we “increase[] the willingness of grantors to create a trust in the first place”;¹²⁷ and (b) at the macro level, more trusts will be “advantageous to potential beneficiaries as a class,”¹²⁸ even if each trust benefits its particular beneficiaries less than it could, i.e., if its assets were used for what they really want (e.g., fancy sports cars or drugs), rather than what the settlor wants them to consume (e.g., education, food, and clothing).

At its core, the case for settlor primacy in trust law rests on its ability to reduce the transaction costs that grantors (gift givers) incur in making gifts. Transaction costs are defined as “[t]hose costs other than price which are incurred in trading goods and services.”¹²⁹ In the context of contract formation, for example, these include the costs of “bargain[ing] with potential sellers (or buyers) to some agreement about exchanging some goods and services for others,” anticipating and “cover[ing] various future contingencies that might affect the agreement,” and “formaliz[ing] the agreement, putting it into the form of an enforceable contract.”¹³⁰ Such costs also arise in the context of trusts, which can be conceived as a contract between the settlor and trustee for the benefit of a third party.¹³¹ As Sitkoff explains, trust law, like contract law, offers a set of standardized terms that can reduce the transaction costs for the settlor-trustee contract: “[b]y invoking the law of trusts, the settlor and the trustee need only record the extent to which their deal deviates from the default governance regime.”¹³²

Critically, Sitkoff assumes that if trust law’s default rules were changed so as to weaken the settlor’s control over the use of her gift, the overall volume of gifting would fall,¹³³ thereby reducing aggregate social wealth. This is reasonable if (a) there is no change in the demand among potential grantors for control over the use of their gifts,¹³⁴ and (b) the default rules for alternative modes of making gifts (e.g., outright transfers) provide grantors with even less control than trust law’s post-change default

126. *Id.* This claim requires assuming that a legal regime defending settlor primacy in private trusts does not create significant negative externalities.

127. *Id.*

128. *Id.*

129. MACMILLAN DICTIONARY OF MODERN ECONOMICS 432 (David W. Pearce ed., 4th ed. 1992).

130. DANIEL H. COLE & PETER Z. GROSSMAN, PRINCIPLES OF LAW AND ECONOMICS 16 (2004).

131. John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625, 627 (1995).

132. Sitkoff, *supra* note 92, at 630 (citations omitted).

133. *Id.* at 659 n.197.

134. For convenience, I assume that the demand of potential settlors for control over their gifts is exogenously defined and thus unaffected by modifying trust law’s default rules to reduce settlor control.

rules. In the post-change world, settlors would have to spend more time and money (i.e., incur additional transaction costs) modifying trust law's default rules to obtain the same level of control afforded by trust law's pre-change default rules. Yet this change would not significantly reduce the transaction costs of grantors who want *less* control over their gift giving (and more donee autonomy) than provided by trust law's post-change default rules. That option was and would still be available under the default rules for other modes of gift giving (e.g., outright transfers).

The broader point is that society is better off offering grantors more rather than fewer modes (i.e., legal vehicles) for gift giving, whose default rules provide grantors with varying degrees of control over a donee's use of a gift. More variety means that each grantor will find a mode whose default rules more closely resemble the degree of control she desires. This in turn reduces the total amount of transactions costs that grantors as a class incur when customizing the various modes' default rules to fit their preferences.

C. Charitable Organizations That Receive Restricted Gifts

In extending an agency analysis of private trusts to charitable trusts, we must take into account, *inter alia*, the special nature of the charitable trust's beneficiaries.¹³⁵ Whereas a private trust must benefit identified or identifiable individuals (e.g., the settlor's children, including those yet unborn¹³⁶), a charitable trust can confer benefits directly upon members of an indefinite class of persons, such as "the poor of the city of Yorkville."¹³⁷ The charitable trust's ultimate beneficiaries, however, are an indefinite class—indeed, the *definitive* indefinite class: the public or the community at large.¹³⁸ In this sense, the immediate recipients of a charitable trust's

135. Among other differences, a private trust can be formed for any legal purpose, and its duration is (or historically has been) limited by the Rule Against Perpetuities, whereas a charitable trust must be formed for a legally charitable purpose and can have infinite duration. See HASKELL, *supra* note 23, at 255–56; Sitkoff, *supra* note 92, at 658 (discussing "the ongoing erosion of the Rule Against Perpetuities" in the private trust context) (citations omitted).

136. If the private trust's instrument does not name all the beneficiaries at the outset, then it must "furnish[] the court and trustee with the requisite means for identifying these beneficiaries during the course of the trust administration." GEORGE GLEASON BOGERT & GEORGE TAYLOR BOGERT, TRUSTS AND TRUSTEES § 363 (2d ed. rev. 1991).

137. *Id.* Although charitable trusts typically benefit an indefinite, open-ended class of persons (e.g., the victims of boating disasters), this is not required. They sometimes can benefit a definite or closed group of persons. The charitableness of such a trust turns on whether the members of this group are sufficiently numerous "so that the community is interested in the enforcement of the trust." RESTATEMENT (SECOND) OF TRUSTS § 375 (1957); see Katz, *supra* note 40, at 262–63.

138. Bogert & Bogert, *supra* note 136, § 363; see James J. Fishman, *Improving Charitable Accountability*, 62 MD. L. REV. 218, 224 (2003) ("Charitable trusts are distinct from private trusts" in that, *inter alia*, "[t]he object of charitable trusts is to benefit the community rather than private individuals.").

largesse (e.g., Yorkville's poor) are the conduits through which the benefits flow to the public.¹³⁹

An agency analysis of the charitable trust draws attention to how trust law addresses the distinct agency problems that arise in this context.¹⁴⁰ Here too, the trustees of a charitable trust can be seen as the agents of two principals—the trust's settlor and its beneficiaries (i.e., the public)—with divergent interests.¹⁴¹ The public may benefit from any number of charitable purposes (e.g., relieving tsunami victims, studying the possibility of life on Pluto), but it benefits from some purposes more than others. All things being equal, the public's interests in any particular trust are best served by putting its assets to their most socially productive use. Any single trust's assets, moreover, almost always can be put to more socially valuable uses than those selected by the settlor. The settlor, by contrast, wants the trust's assets to be used for *her* specified purposes, even if other purposes could benefit the public more.¹⁴² The settlor's agency problem vis-à-vis the trustees is aggravated by the fact that a charitable trust can last as long as our legal system. Given this time horizon, the trustees will inevitably develop idiosyncratic charitable objectives that differ from the settlor's.

As this analysis shows, a charitable trust's trustees may be tempted to diverge from the settlor's instructions in order to generate what they believe is a greater benefit for the beneficiaries (i.e., the public) or to advance their own idiosyncratic charitable objectives. Trust law forbids this. In any particular trust, trust law favors the settlor's charitable objectives—even if motivated by paternalistic or impure altruism—over the public's interests or the trustees' charitable objectives. It does so by requiring the trustees to advance the settlor's specific charitable purpose insofar as it can be advanced (within reason). Here, as in the private trust context, settlor primacy assumes that: (a) the number of charitable trusts created reflects the would-be settlor's level of confidence that her instructions will be followed; and

139. BOGERT & BOGERT, *supra* note 136, § 363.

140. The following analysis also applies to restricted gifts received and held in trust by charitable corporations. See *supra* notes 34–39.

141. See, e.g., *Smithers v. St. Luke's-Roosevelt Hosp. Ctr.*, 723 N.Y.S.2d 426, 435 (N.Y. App. Div. 2001) (the attorney general and donor have related but distinct and sometimes incongruent interests in a charitable gift; the donor seeks to have his or her intent faithfully executed, whereas the Attorney General promotes the interests of the gift's beneficiaries); *Holt v. Coll. of Osteopathic Physicians & Surgeons*, 394 P.2d 932, 936 (Cal. 1964) (“[Gifts made to a] charitable institution can be used only for the purposes for which they were received in trust. The trust is not fulfilled merely by applying the assets in the public interest.”).

142. Stated differently, the settlor is likely to be an impure altruist who seeks to alter the public's consumption of goods and services, rather than increase social welfare as broadly understood or objectively defined. A purely altruistic settlor, by contrast, is more inclined to create a trust simply “for charitable purposes.”

(b) at the macro level, more charitable trusts will produce more social benefit overall, even if each trust benefits society less than it could. As Professor Brody explains:

In general, the law honors donors' restrictions on charitable gifts, often into perpetuity, in order to encourage charitable giving. In deciding between devoting their property to charitable use and keeping it in the family, donors take into account the likelihood that their donated property will remain governed by their wishes. Implicitly the state has determined that net social welfare increases by permitting the dead hand of the testator to dictate the enjoyment of donated wealth forever.¹⁴³

Yet this is not the whole story. At the micro level, trust law does not completely subordinate the public's interests to the settlor's. If the trust's specific purpose is thwarted, the doctrine of cy pres sets a rebuttable default rule that keeps the trust's assets flowing in charitable channels,¹⁴⁴ where they presumably will benefit the public more than if returned to the settlor or her residuary legatees.¹⁴⁵ Courts can exercise this power, moreover, even if the settlor would have wanted the assets to return to her or her residuary legatees, unless the trust instrument expressly states this preference.¹⁴⁶ Additionally, some authorities hold that in selecting a substitute purpose "among purposes reasonably close to the [settlor's] original [purpose]," a court may pick the one that "has a distinctly greater usefulness

143. Evelyn Brody, *The Legal Framework for Restricted Gifts: The Cy Pres Doctrine and Corporate Charities 1* (draft Nov. 2003) (unpublished manuscript, on file with author).

144. *Supra* notes 42–43 and accompanying text. This defect could cause a private trust to fail. *See* RESTATEMENT (THIRD) OF TRUSTS § 67 cmt. *b* (2003). Comment *b* provides:

The cy pres doctrine is not applicable to private trusts. There are, however, narrower but analogous principles that apply to both private and charitable trusts, as particularly illustrated by the rule of equitable deviation in § 66 allowing courts, in certain circumstances, to modify the means of accomplishing a trust purpose.

Id.

145. *See* Jonathan R. Macey, *Private Trusts for the Provision of Private Goods*, 37 EMORY L.J. 295, 306 (1988). Macey noted:

An alternative rule which stipulates that the settlor's assets always revert back to his heirs whenever any significant aspect of the settlor's intentions are thwarted, unless the settlor provides for a contrary result, . . . would provide a better guide to courts on the value to the settlor of his second choice asset allocation.

Id.

146. RESTATEMENT (THIRD) OF TRUSTS § 67 (2003) (providing that cy pres applies "unless the terms of the trust provide otherwise"). "In theory," however, "the doctrine of cy pres exists to effect the unstated intent of the settlor" or, rather, what the settlor would have wanted "had he thought about the matter." HASKELL, *supra* note 23, at 262. One can thus argue, as does Judge Richard Posner, that the cy pres doctrine facilitates both social efficiency and donor intent:

[S]ince no one can foresee the future, a rational donor knows that his intentions might eventually be thwarted by unpredictable circumstances and may therefore be presumed to accept implicitly a rule permitting modification of the terms of the bequest in the event that an unforeseen change frustrates his original intention.

RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 556 (5th ed. 1998); *see id.* at 557.

than the others.”¹⁴⁷ This approach serves the public’s micro interests more than the traditional rule, which required the substituted purpose to be “as near as possible” (from the Norman French term “cy pres comme possible”) to the original one, without regard to its social value.¹⁴⁸ Trust law also vests the cy pres power in the court and not the trustees.¹⁴⁹ As a result, the substitute purpose is more likely to maximize the public welfare rather than conform to the trustees’ idiosyncratic charitable objectives.

IV. MISSION ACCOUNTABILITY IN CHARITABLE CORPORATIONS: AN AGENCY THEORY ANALYSIS

An agency theory analysis of trust law, and agency theory in general, can sharpen our thinking about mission accountability in the charitable corporation as such. First, it provides a useful way to describe and analyze the tensions within and among a charitable corporation’s constituent relationships. Second, it clues us in to a normative argument for maintaining a diversity of legal forms and default regimes for charitable activities: such diversity reduces the transaction costs that informed philanthropists incur in tailoring off-the-rack legal forms to match their preferences as to how much discretion to delegate to a charity’s governing body. When it comes to setting default rules for uninformed philanthropists, however, the policy of reducing transaction costs may give way to broader social concerns.

A. *Agency Theory Offers Users Descriptive and Analytical Tools*

What can an agency theory analysis of trust law teach us about mission accountability in the charitable corporation as such (i.e., unrelated to its status as the trustee of restricted gifts)? As a first cut, agency theory offers a potentially useful set of descriptive and analytical tools. The typical charitable corporation has numerous parties (“stakeholders”) interested in its operations and who make demands on it. In a nonmembership charity, these include: the person(s) who create the corporation; those who purchase its services and goods for their personal consumption (“clients”); employees; volunteers; the specific community in which it operates; the public in general (i.e., the ultimate beneficiary); and members of the board of directors. If we posit the board as an agent, we can identify its prospective prin-

147. RESTATEMENT (THIRD) OF TRUSTS § 67 cmt. *d* (2003).

148. See Triantis, *supra* note 29, at 1158 (noting that under traditional cy pres doctrine, “courts are confined to authorizing a substitute purpose based on similarity to the original purpose rather than on social value”).

149. RESTATEMENT (THIRD) OF TRUSTS § 67 cmt. *d* (2003).

cipals by asking which stakeholders stand to benefit from the directors' activities, and whose relationship with the directors can be meaningfully described using a contract metaphor. For each prospective principal, we can analyze their agency problem vis-à-vis the directors and consider ways to mitigate that problem.

This can be a useful exercise. At the very least, it provides a formal explanation for why a board of directors—even with full information and the best of intentions—cannot define the corporation's mission in a way that pleases everybody: the board (to paraphrase Professor Sitkoff) is saddled with the friction of numerous and potentially competing principal-agent relationships.¹⁵⁰ To gain more leverage from agency theory, however, we must answer the normative question (as posed by Professor Brody): “Who are the ‘principals’ to whom society *wants* the [charitable corporation's directors] to answer[?]”¹⁵¹ Once we identify the privileged principal, “we can then ask the subsequent question of how to align the interests of the charity with the interests of the principals.”¹⁵² Otherwise, the pursuit of mission accountability is a Rashômon-like exercise in which “[o]ne stakeholder's mission drift might be another's appropriate responsiveness, and each of these conflicting characterizations is correct from that [party's] perspective.”¹⁵³

In a charitable trust, the settlor's claim to the status of (primary) principal may seem self-evident.¹⁵⁴ This is less true of (or flat wrong for) the nonmembership charitable corporation that holds no restricted gifts. Trust law parallelism seeks to export trust law's responses to the settlor's agency problem into nonprofit corporate law. This project is complicated by the fact that the typical settlor is both a charity's founder *and* funder, whereas these roles typically are split in a charitable corporation. Trust law parallelism deals with this by offering a two-part answer to the “who is the principal” question. The donors of unrestricted gifts (“general donors”) are the preeminent “principals” as to a corporation's assets attributable to their gifts, on par with donors of restricted gifts. The charitable trust doctrine addresses these donors' agency problem vis-à-vis the directors—i.e., will

150. Sitkoff, *supra* note 92, at 624.

151. Brody, *supra* note 100, at 512.

152. *Id.*

153. Brody, *Accountability and Public Trust*, in *THE STATE OF NONPROFIT AMERICA* 471, 472 (Lester M. Salamon ed., 2002).

154. But it is not. See, e.g., Brody, *supra* note 100, at 461 (“[W]hether society wants to privilege donors with shareholder-like control is a normative question.”); *id.* at 512 (“Who are the ‘principals’ to whom society wants the charity to answer—in some way greater than the usual demands of resource dependency?”) (emphasis added).

the board use its assets attributable to unrestricted gifts for the charitable objectives set forth in the articles of incorporation's statement of purposes (or as manifested in the charity's operations) at the time their gifts were accepted?

The corporate founder is the primary principal of the corporation as such (i.e., independent of any gifts received), and her situation is analogous to the settlor of a trust. The founder, like the settlor, sets forth her statement of the charity's purposes in its organic document.¹⁵⁵ Trust law addresses the settlor's agency problem vis-à-vis the trustee by obligating the trustee to administer the trust "in a manner faithful to the expressed wishes of the creator."¹⁵⁶ So too, the duty of obedience addresses the founder's agency problem vis-à-vis the board.

The analogy between a trust's settlor and a corporate founder is plausible. The archetypal settlor and archetypal founder (sometimes called a "social entrepreneur"¹⁵⁷) each endows her charity with distinctive resources. The settlor contributes existing and definite interests in property, such as land or stock that she presently owns.¹⁵⁸ The founder's most important inputs, by contrast, are unlikely to constitute a "corpus" or "res" under trust law.¹⁵⁹ These consist of the time, energy, and creativity she invests into the enterprise,¹⁶⁰ and the opportunities she foregoes in doing so. Yet the founder's contributions can be as vital to her enterprise's success as the settlor's property is to the trust's. Over time, these inputs can ripen into more conventional property interests. In a commercial nonprofit, for example, this includes the corporation's value as a going concern.¹⁶¹

155. See RESTATEMENT (SECOND) OF TRUSTS § 4 & cmt. *a* (1959) (summarizing what the phrase "terms of the trust" comprises); ALI, Nonprofit Law, Council Draft No. 1, *supra* note 2, § II-11 (defining "organic documents" to include "the articles of incorporation and bylaws of a nonprofit corporation"). Note that the founder's and general donors' charitable objectives are not identical if the corporation was no longer advancing its original purposes when the general donors' gifts were received.

156. KURTZ, *supra* note 17, at 85 (citations omitted); accord FISHMAN & SCHWARZ, *supra* note 30, at 230 (citation omitted); SASSO, *supra* note 65, at 1529.

157. See, e.g., PETER FRUMKIN, ON BEING NONPROFIT: A CONCEPTUAL AND POLICY PRIMER 26-27 (2002).

158. RESTATEMENT (SECOND) OF TRUSTS §§ 74-76 (1957).

159. *Id.* § 74 ("A trust cannot be created unless there is trust property."). In most cases, the founder also transfers at least some capital or other present property interests to the incorporating entity.

160. *Id.* § 74 cmt. *b*:

The knowledge or skill which a man possesses is not property. It is true that he can make an agreement to communicate his knowledge and to exercise his skill, but such an agreement is not a transfer of property and is binding only if the requirements for the formation of a contract are complied with.

161. BLACK'S LAW DICTIONARY 1587 (8th ed. 2004) (defining "going-concern value" as "[t]he value of a commercial enterprise's assets or of the enterprise itself as an active business with future earning power, as opposed to the liquidation value of the business or of its assets," and as including "goodwill"). This value includes the enterprise's goodwill; *id.* at 715 (defining "goodwill" as "[a]

An analogy is not an argument. Trust law parallelism does not directly explain *why* nonprofit corporate law should treat a charitable corporation's founder and general donors as its principals. Rather, it evades the normative question by pushing it back a step: (a) it is self-evident that a settlor ought to be deemed the trust's primary principal; (b) a founder and general donors can be analogized to the settlor; (c) therefore, the founder and general donors ought to be deemed the charitable corporation's primary principal. A normative argument can be made to support the first step in this syllogism, as argued above. Unfortunately, trust law parallelism learns the wrong lesson from that argument.

B. *Trust Law Parallelism and the Informed Philanthropist*

Part III of this Article argued that it is more efficient to offer grantors a wider rather than narrower range of legal forms for making private gifts, as this makes it more likely that each grantor will find a form whose default rules fit her needs or preferences with a relatively small amount of tinkering—thereby reducing her transaction costs. In practice, this means that trust law's default rules should be very protective of a settlor's instructions—let trusts be trusts!—and so provide control-seeking grantors with a giving mode tailored to their needs. The alternative approach—i.e., default rules that weaken settlor control—would make trusts function more like other (less settlor-protective) gift-giving modes. This would increase the transaction costs of control-seeking grantors, without reducing the transaction costs of more easygoing grantors. The overall effect likely would be to reduce the total amount of giving. These same arguments counsel *against* trust law parallelism, albeit from the perspective of philanthropists (defined broadly to include charity founders, donors, and volunteers) who want donees to have *more* control over their contributions.

Some philanthropists believe, reasonably so, that a charity's governing body has more information about current charitable needs and new opportunities for generating more social benefits, as well as more expertise in meeting such needs and exploiting such opportunities. They favor board discretion insofar as this makes it easier to shift the charity's resources to more socially valuable uses.¹⁶² For the same reason, some philanthropists favor broad statements of purposes in a charity's organic documents.¹⁶³

business's reputation, patronage, and other intangible assets that are considered when appraising the business, esp. for purchase; the ability to earn income in excess of the income that would be expected from the business viewed as a mere collection of assets").

162. See generally Triantis, *supra* note 29.

163. As Professor Triantis explains:

Under corporate law parallelism, the default rules for charitable corporations grant boards of directors extensive discretion over the corporate mission and general assets. These default rules more accurately reflect the easygoing philanthropist's preferences as compared to a trust, and thus reduce her costs of tailoring an off-the-rack legal form to fit her needs. If these liberal default rules were replaced with more restrictive ones—i.e., a robust duty of obedience (which demands that directors preserve a corporation's original purposes) and the charitable trust doctrine (which curbs the board's discretion over unrestricted gifts)—then charitable corporations would function more like charitable trusts. Instead of two distinct default regimes for director discretion (restrictive trust law and permissive corporate law), trust law parallelism would give us two variations on the same theme—restrictive trust law and somewhat less restrictive corporate law (or trust law “lite”).

Those who want more discretion for boards would have to spend more time and money tailoring the available (and more restrictive) legal forms to fit their more easygoing preferences. Moreover, trust law parallelism would increase the easygoing philanthropists' transaction costs without significantly reducing the transaction costs of philanthropists who want to curb board discretion (because trust law already provides them with a set of default rules that accomplish this). The end result of trust law parallelism is to make it more costly for informed philanthropists to secure the form of charitable governance they favor. This in turn may slow the total number of charities formed and the growth of existing ones. The upshot is that we can promote efficiency by letting charitable corporations be *corporations*—i.e., embrace corporate law parallelism.

C. *Trust Law Parallelism and Uninformed Philanthropists*

The informed philanthropist is one who, in the words of the Delaware Supreme Court, “recognizes that different legal rules govern the operation of charitable trusts and charitable corporations and selects a form with those rules in mind.”¹⁶⁴ A significant number of philanthropists, one sur-

[T]here may be good reasons for the existence of organizations that pursue multiple charitable purposes. A broad organization may be justified by economies of scope in pursuing related charitable projects that are not readily realized by contracts between corporations. A charity may have specific information about a community that enables it to provide food, clothing, education, and health care efficiently to the same beneficiaries. This information may not be as effectively transmitted between even well-meaning separate organizations. Similarly, there may be organizational or administrative economies in multipurpose charities.

Id. at 1150.

164. *Oberly v. Kirby*, 592 A.2d 445, 466–67 (Del. 1991). The court was referring to charity organizers, whom it assumes know the legal differences between charitable trusts and charitable corporations.

mises, are uninformed or underinformed in this respect. Professor Brody reports that “[i]n practice, . . . rarely does the founder of a charity carefully consider the legal differences [between a charitable trust and a charitable corporation] and make a choice based on the advantages of organizational form.”¹⁶⁵ Regrettably, a charity organizer may not learn much more from some attorneys. Most U.S. lawyers recommend the corporate form to their philanthropic clients,¹⁶⁶ perhaps because more lawyers work with corporations than trusts.¹⁶⁷ Similarly, estate lawyers may steer their clients towards trusts, a staple of their practice.¹⁶⁸ As a result, at least philanthropists choose the corporate form without realizing that it grants the governing body far more power over the mission and unrestricted gifts.¹⁶⁹ To use an extreme example, those who form or fund a charitable corporation to shelter abandoned animals probably do not know or expect that a future board could or would convert the entity into an institute for vivisection research.¹⁷⁰ This would never happen in a charitable trust.

How should the plight of the uninformed philanthropist affect our choice of default rules for charitable corporations? The answer might turn on what we know, believe, or guess a majority of such philanthropists would have done if they had full information—i.e., if they knew the relevant differences between charitable trusts and charitable corporations.¹⁷¹ The idea here is that we can reduce transaction costs by setting default rules to reflect what a majority would have wanted had they thought about it.¹⁷² Accordingly, the argument for more restrictive, trust law-like default rules for charitable corporations would be stronger if, under such conditions, a majority of charity organizers would have entrenched their specific charitable purposes against tampering by the governing body. They could have

165. Evelyn Brody, *The Limits of Charity Fiduciary Law*, 57 MD. L. REV. 1400, 1417 (1998). *But see Oberly*, 592 A.2d at 467 (asserting that philanthropists understand the difference between a trust and nonprofit corporation when they make their gifts, and when they use the corporate form, they “invoke[] the far more flexible and adaptable principles of corporate law”).

166. ALI, Nonprofit Law, Council Draft No. 1, *supra* note 2, § 200 cmt. a.

167. FISHMAN & SCHWARZ, *supra* note 30, at 63 (“A particular advantage of the nonprofit corporate form is that the governing statutes are comparable to state corporate law. This similarity offers a familiar model to a nonprofit corporation’s legal counsel as well as a body of analogous case law that often can be transported to the nonprofit context.”).

168. ALI, Nonprofit Law, Council Draft No. 1, *supra* note 2, mem. at 4.

169. Conversely, some philanthropists may choose the trust form even though it gives trustees less flexibility over the mission than they would like, if asked.

170. *See Attorney General v. Hahnemann Hosp.*, 494 N.E.2d 1011, 1021 n.18 (Mass. 1986).

171. Alternatively, we can ask what terms the philanthropists and the donee charity would have bargained for if they had full information and low negotiation costs. *But see Sitkoff*, *supra* note 92, at 644 n.109 (noting assertions that, in the context of private donative trusts, “settlers simply do not dicker with trustees”).

172. *Id.* at 644 (citations omitted).

done this either by selecting the trust form or, if they chose the corporate form, by including certain provisions in the corporation's articles of incorporation, such as: prohibiting the board from changing the original charitable purposes without first determining that these had failed or been fulfilled;¹⁷³ requiring a supermajority of board members to change the charitable purposes; prohibiting the board from changing the charitable purposes; or requiring any amendment to the charitable purposes to be approved by some party other than the board.¹⁷⁴ Similarly, it would strengthen the argument for more trust law-like default rules for unrestricted gifts if, under such conditions, a majority of general donors would have imposed restrictions on the use of their gifts—for example, by prohibiting the charity from using their gifts for any purpose other than those set forth in the charity's statement of purposes when it received their gifts. Conversely, the case for the status quo would be stronger if a majority would have chosen it.

We do not know the answer to this question. In the face of such uncertainty, common sense suggests that we pick the default rule that generates more social benefits than the alternative(s). All things being equal, it is more efficient to permit a charity's governing body to redirect its charitable mission and assets. Because a living hand can respond to unforeseen changes, act upon new information, and exploit new opportunities, more discretion for the governing body facilitates the use of the charity's resources in ways that benefit society more than do the uses selected by the charity organizer or past donors.

Yet even if we know that a majority of uninformed philanthropists would have wanted more trust law-like default rules for charitable corporations, this is not the last word. Default rules can advance policies other than (or in addition to) reducing the transaction costs of making various arrangements. The laws of intestacy, for example, typically put the surviving spouse and descendants at the front of the line to inherit the decedent's estate.¹⁷⁵ If there are no descendants, the estate may be divided between the surviving spouse and the decedent's parents.¹⁷⁶ Whether or not these rules

173. The ALI Council Draft expressly rejects this provision as a default rule. See ALI, Nonprofit Law, Council Draft No. 1, *supra* note 2, § 240(c)(1).

174. See, e.g., IND. CODE § 23-17-17-1 (2005).

175. See, e.g., *id.* § 29-1-2-1(b)(1) (“[T]he surviving spouse shall receive . . . [o]ne-half (1/2) of the net estate if the intestate is survived by at least one (1) child or by the issue of at least one (1) deceased child.”); *id.* § 29-1-2-1(d)(1) (“The share of the net estate not distributable to the surviving spouse, or the entire net estate if there is no surviving spouse, shall descend and be distribute . . . [t]o the issue of the intestate.”).

176. See, e.g., *id.* § 29-1-2-1(b)(2) (“[T]he surviving spouse shall receive . . . [t]hree-fourths (3/4) of the net estate, if there is no surviving issue, but the intestate is survived by one (1) or both of the

effectuate the (unexpressed) wishes of most intestates, they direct the decedent's assets to those people in his circle who are most likely to become destitute without them. These rules thus protect the public fisc by reducing the number of financially vulnerable people requiring public support.

Similarly, we can define the default rules for charitable corporations in ways we hope will do more for society than simply reduce the transaction costs of philanthropists (or compensate for the lost gifts due to the increase in such transaction costs). Rigid adherence to a charity's original mission or a charitable gift's original terms is, in the long run, likely to frustrate the rational and efficient use of these resources.¹⁷⁷ The trick is how to peel charitable assets from the dead hands of philanthropists without discouraging living persons from becoming philanthropists. Insofar as this is possible, it is probably more readily accomplished against charitable corporations created by, as well as unrestricted gifts donated by, uninformed philanthropists. If these philanthropists were uninformed when they selected the corporate form or made an unrestricted gift, there is a decent chance that they will stay uninformed, and theoretically what they do not know cannot hurt them.

There are risks to setting a default rule at odds with what a (hypothetical) majority would have chosen. When previously uninformed contributors learn about the rule, they may be very angry—especially if a charity exercised its lawful discretion over its mission, assets, or both in ways that the donor did not actually intend and would not have approved. This is apparently what happened after 9/11, when many people became famously outraged over the American Red Cross's initial plan to use some Liberty Fund ("Fund") donations for purposes not directly related to 9/11 relief.¹⁷⁸ This outrage was not abated by the facts that (a) most donors to the Fund did not expressly restrict their gifts to 9/11 relief and (b) the Fund's organic document stated that its moneys would be used for numerous purposes, such as creating a reserve for responding to future attacks involving weapons of mass destruction.¹⁷⁹ Because of the American Red Cross's high visibility in 9/11 relief, the controversy surrounding the Liberty Fund tem-

intestate's parents."); *id.* § 29-1-2-1(d)(2) ("If there is a surviving spouse but no surviving issue of the intestate, then [the share of the net estate not distributable to the surviving spouse shall descend and be distributed] to the surviving parents of the intestate.").

177. ALI, Nonprofit Law, Council Draft No. 1, *supra* note 2, § 240 rptr's note 10; POSNER, *supra* note 146, at 556–57.

178. See Katz, *supra* note 40, at 306–14 (discussing the American Red Cross's response to 9/11).

179. *Id.* at 316–20 (assessing the allegation that the American Red Cross failed to honor donor intent).

porarily may have dissuaded some people from contributing to any charity.¹⁸⁰

These risks are real, but the better way to handle them is to let each charity decide how to exercise its discretion and how much it wishes to tell potential donors about the lawful range (or self-imposed limits) of its discretion. This gives most charitable corporations more discretion in more cases, to society's gain, while putting the burden on each charity to decide when the harms of exercising their discretion outweigh the benefits. For example, after its unpleasant experience with the Liberty Fund, the American Red Cross rewrote its solicitation materials to clarify its multipurpose use of unrestricted gifts to its general disaster relief fund.¹⁸¹ It also undertook to contact each donor of an unrestricted gift to ensure that all donors understand the scope of the charity's discretion on how to use their gift.¹⁸²

CONCLUSION

When viewed in isolation, corporate law parallelism—the policy of modeling nonprofit corporate law after for-profit corporate law—seems to aggravate concerns about mission accountability in charitable corporations, an alleged problem to which trust law parallelism may seem an antidote. A broader perspective, however, underscores in two respects the wisdom of the default rules that grant expansive discretion to the boards of charitable corporations. First, by accentuating the legal differences between charitable corporations and charitable trusts, we can reduce the transaction costs of informed philanthropists who prefer to start and support charities whose governing bodies have extensive discretion over the objectives and assets. By reducing the transaction costs of engaging in charitable activity, we thereby can increase the total volume of such activity—to society's betterment. Second, a policy of corporate law parallelism can increase the efficacy of charitable resources. Many unsophisticated or uninformed philanthropists will start and support charitable corporations, even though they would prefer to curb a charity's governing board's control over its objectives and assets, and even though with fuller information they would have chosen to start and support charitable trusts (which we have seen are not as likely to maximize their benefit to society as are charitable corpora-

180. See Triantis, *supra* note 29, at 1151 & n.159 (“A year after the attack, a poll found that twenty-nine percent of Americans surveyed were less likely to donate to any charity because of the attempted diversion of donations dedicated to 9/11 relief efforts.”) (citing a poll conducted by Harris Interactive for The Chronicle of Philanthropy).

181. See Katz, *supra* note 40, at 315–16.

182. *Id.*

tions). By increasing the number of charities and volume of charitable assets overseen by boards with extensive discretion, corporate law parallelism facilitates the application of these charities' resources to more socially beneficial uses.