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THE NONPROFIT SECTOR AND THE NEW STATE ACTIVISM

*Mark Sidel**

A CORPORATE FORM OF FREEDOM: THE EMERGENCE OF THE NONPROFIT SECTOR (NEW PERSPECTIVES ON LAW, CULTURE AND SOCIETY). By *Norman I. Silber*. Boulder: Westview Press. 2001. Pp. 184. \$29.

The burgeoning field of nonprofit and philanthropic law has a new and superb history in Norman Silber's pathbreaking *A Corporate Form of Freedom: The Emergence of the Nonprofit Sector*. In confronting "the history of efforts to control the creation and permissible purposes for nonprofit corporations by states, and . . . the relocation of these efforts to the Internal Revenue Service" (p. 5), Professor Silber effectively delineates the rich history of our ambiguous, often conflicted attempts to regulate the American nonprofit sector, and points clearly to the ways in which history influences the current complexities of state regulation. From a discredited era of state intrusion into the purposes and goals of nonprofit formation, a history admirably analyzed by Silber's volume, we have now turned to an inconsistent pattern of several decades of post-registration state monitoring of the nonprofit sector — in some jurisdictions a virtual ceding of nonprofit monitoring to the Internal Revenue Service, and in others a new state activism well worth exploring.

The struggle to effectively balance oversight with freedom in the regulation of the American nonprofit sector is a key theme of Silber's work. This is, of course, a long-standing problem in American law. Because of continuing concerns for the efficacy of IRS oversight, limitations on the right of citizens to have standing to sue upon misconduct by nonprofits, and a virtual absence of effective means of self-regulation in the nonprofit sector, states — led by New York — have at times aggressively exercised their powers to monitor, oversee and regulate the nonprofit sector. At least one key state appears to be doing so now. Given the failure, or at least the limitations, of other oversight means, it is perhaps inevitable that the states should step into this

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fray. That new state activism is well worth exploring in its own right — but it is also not without significant problems, inconsistencies, and limitations, as this Review indicates. The time has perhaps now arrived to put the new state activism into an analytical framework that can help determine its utility in the regulation of the rapidly growing and now considerably more complex American nonprofit sector.

I. THE CHECKERED HISTORY OF AMERICAN NONPROFIT REGULATION AND THE DISCRETIONARY TRADITION

Today the American nonprofit sector is, in Silber's words:

integral to the national economy and a valued part of [our] social fabric [It] embodies the philanthropic goodness, conviviality, cultural excitement, and democratic spirit of the American people [and] has provided a valued social location in which groups can operate without pecuniary obsessions and with measures of success that are not necessarily related to financial profitability. (p. 2)

Yet organizations within the sector do not — perhaps should not — coordinate activities and policies particularly effectively with each other; that joyous chaos may be one of the chief attributes of American civil society. The issues are legion: misconduct in the nonprofit sector, such as the United Way debacle of the early 1990s;¹ coordination and relief problems after September 11, including the problems faced by the American Red Cross;² a continuing convergence between nonprofit and for-profit organizational forms and goals; weak self-regulatory mechanisms in the sector; and many others. We have little in the way of direct, resource-favored supervisory power to rely upon even if we would wish to do so. The Internal Revenue Service remains an uneven regulator of the sector, and many states devote very few personnel or resources to nonprofit oversight.³

1. The United Way head used more than \$600,000 in United Way funds for personal expenses and travel. See Karen W. Arenson, *Former United Way Chief Guilty in Theft of More Than \$600,000*, N.Y. TIMES, Apr. 4, 1995, at A1; Felicity Barringer, *United Way Head is Forced Out in a Furor Over His Lavish Style*, N.Y. TIMES, Feb. 28, 1992, at A1; see also *United States v. Aramony*, 88 F.3d 1369 (4th Cir. 1996), cert. denied, 520 U.S. 1239 (1999). Useful commentaries include Evelyn Brody, *Institutional Dissonance in the Nonprofit Sector*, 41 VILL. L. REV. 433 (1996); Susan Gary, *Regulating the Management of Charities: Trust Law, Corporate Law, and Tax Law*, 21 HAW. L. REV. 593 (1999); Harvey J. Goldschmid, *The Fiduciary Duties of Nonprofit Directors and Officers: Paradoxes, Problems, and Proposed Reforms*, 23 J. CORP. L. 631 (1998).

2. Nick Cater, *Attack Response Marred by Charities' Missteps*, CHRON. OF PHILANTHROPY, Nov. 29, 2001, at 37 (reviewing missteps at the Red Cross); Deborah Sontag, *What Brought Bernardine Healy Down*, N.Y. TIMES MAG., Dec. 23, 2001, at 32 (reviewing Red Cross post-September 11 fundraising and controversies); Grant Williams, *Turmoil at the Red Cross*, CHRON. OF PHILANTHROPY, Nov. 1, 2001, at 71 (reporting spreading of questions raised surrounding September 11-related issues).

3. See, e.g., Evelyn Brody, *The Limits of Charity Fiduciary Law*, 57 MD. L. REV. 1400 (1998); Laura Brown Chisolm, *Sinking the Think Tanks Upstream: The Use and Misuse of Tax Exemption Law to Address the Use and Misuse of Tax-Exempt Organizations by Politi-*

And so, at least in many states, our legal regime for the nonprofit sector works well in the good days and badly in the tougher times, when some form of closer observation might be useful. But even in the better days, the weak state of nonprofit regulation sparks exposés of nonprofit deficiencies⁴ and reflexive calls to tighten regulation, often beginning with moves to reimpose property taxation on nonprofits⁵ or to over-regulate — in Silber’s words, “threaten[ing] to eliminate all of the important privileges for all organizations, not just the abusers” (p. 4; italics omitted). The evolution of nonprofit regulation is the primary topic of Professor Silber’s book and may shed some light on the future of nonprofit oversight.

Early in our history, state legislatures retained power over the American charitable sector through the power to charter nonprofit corporations. In the mid-nineteenth century, state legislatures “gave judges in some states and bureaucrats in others the primary authority to stand guard at the main entrance to the sector and to monitor organizational changes to existing groups” (p. 5). Much of Silber’s book is about the judicial strand of this second period in nonprofit regulation, when state legislatures ceded substantial control of gate-keeping and monitoring functions to judiciaries in some states and executive branch officials in others. This long period, from about the 1850s until the 1950s was marked in judge-dominant states, by a “vigorous expansion” of judicial power, and, at least in New York, by “[holding] onto a discretion which became so strong that their personal reservations — religious, political, class, cultural, racial, and social — as a matter of legal doctrine were sufficient to sanction disapproval” (p. 5). Silber’s volume is at its best in exposing the political, religious, racial, social, and cultural biases that helped to guide judicial decisions on nonprofit registration in New York in the late nineteenth century and the first half of the twentieth century. Based loosely on the statutory guide that judges approve only nonprofit applications with “lawful” purposes, judicial discretion developed through rejection of blanket

cians, 51 U. PITT. L. REV. 577 (1990); George Rodrigue, *For America’s Nonprofit Sector, the Watchdog Seldom Barks*, NIEMAN REP., Mar. 22, 1998, at 50, 56.

4. Gilbert Gaul and Neil Borowski’s series on this theme was nominated for the Pulitzer Prize in 1994. See GILBERT GAUL & NEIL BOROWSKI, *FREE RIDE: THE TAX-EXEMPT ECONOMY* (1993).

5. For an earlier review of this debate, see *Developments in the Law — Nonprofit Corporations*, 105 HARV. L. REV. 1578 (1992). For more recent discussions, see Rob Atkinson, *Theories of the Federal Income Tax Exemption for Charities: Thesis, Antithesis, and Syntheses*, 27 STETSON L. REV. 395 (1997); Evelyn Brody, *Of Sovereignty and Subsidy: Conceptualizing the Charity Tax Exemption*, 23 J. CORP. L. 585 (1998); Barbara K. Bucholtz, *Reflections on the Role of Nonprofit Associations in a Representative Democracy*, 7 CORNELL J. L. & PUB. POL’Y 555 (1998); John D. Colombo, *The Marketing of Philanthropy and the Charitable Contributions Deduction: Integrating Theories for the Deduction and Tax Exemption*, 36 WAKE FOREST L. REV. 657 (2001); and Nina J. Crimm, *Why All Is Not Quiet on the “Home Front” for Charitable Organizations*, 29 N.M. L. REV. 1 (1999).

approval of charters and the cultivation of a “jurisprudence of privilege which required applicants further to demonstrate that their conduct would be socially beneficial, from the judge’s perspective” (p. 32).

Silber traces a string of these cases, beginning with the rejection of Augudath Hakehiloth, a social services and mutual aid association for immigrants, whose application indicated that its meetings would occur on Sundays. “A thing may be lawful, and yet not laudable,” wrote the trial court judge to whom the approval petition was brought under the New York General Laws of 1895.⁶ Membership meetings on Sunday violated “the public policy of the state, if not to [the] letter of its law.”⁷ In the years that followed, New York’s judges expanded their interpretation of the language of the 1895 Membership Corporation Law, which in Silber’s words “explicitly required . . . judicial approval of [nonprofit] certificates,” and allowed judicial interpretation of the eligibility requirement of “any lawful purpose” contained in the statute (p. 35). The judicial role would not be merely ministerial, but substantive as well:

The Legislature has prescribed simple means by which an artificial entity may be created, and, when created, endowed with certain powers and privileges. What more reasonable than that, before imparting legal life, there should be judicial scrutiny of those qualifications which the law makes essential, and not a mere perfunctory passing on what may be presented.⁸

The implementation of this doctrine by New York judges took several forms. A white Elks organization received judicial support in its attempt to block the registration of a black Elks organization, ostensibly as a consumer protection device to avoid confusion in organizational names.⁹ But, as Silber points out, “[c]loaking obtuseness as impartiality allowed the court to use the incorporation law to perpetuate the social and cultural separation of the races” (p. 38). Other cases extended the rationales for judicial intervention, especially following the first World War and during the Red Scare of the 1910s and 1920s. Allowing a Catalonian Nationalist Club to incorporate in New York in 1920 would not, in the words of the deciding judge, reflect “that the great need of the time is the teaching of American ‘culture’ ” rather than the slowing of “homogeneity.”¹⁰ The amended certificate of the Lithuanian Worker’s Literature Society, which was made up of

6. P. 32 (quoting *In re Agudath Hekahiloth*, 42 N.Y.S. 985, 987 (Sup. Ct. 1896)).

7. *Id.*

8. P. 36 (quoting Justice Goff in *In re Wendover Athletic Ass’n*, 128 N.Y.S. 561, 562 (Sup. Ct. 1911)).

9. *Benevolent & Protective Order of Elks v. Improved Benevolent & Protective Order of Elks of the World*, 98 N.E. 756, 757 (N.Y. 1912).

10. Pp. 39-40 (quoting *In re Catalonian Nationalist Club*, 184 N.Y.S. 132 (Sup. Ct. 1920)).

Socialist Party members and sought to publish socialist materials, was disapproved because it would publish “propaganda, which our Penal Law makes criminal and even felonious.”¹¹ Judicial and executive intervention sought to govern the extension of nonprofit corporations in certain business activities by asserting their “own role in determining the boundaries for nonprofit corporate activities and widen[ing] those boundaries to allow new opportunities for business activities, provided they were technically compliant with established rules.”¹²

Silber provides other useful examples of the perils of the discretionary period as well, making a strong argument that judges and their biases predominated in nonprofit chartering decisions in New York and other states between the mid-nineteenth and mid-twentieth centuries (pp. 48-81). As Silber shows at least briefly, the stereotypes and political views that New York judges reflected were also found in other state courts (p. 5). But then Silber attempts to broaden the applicability of these state court opinions: “For a considerable part of American history, therefore, the thought of officials about what was a proper role for nonprofits can be illuminated by analyzing the actions of common law judges in New York, Pennsylvania, and the other states in which reported opinions can be found” (p. 5). What of the other states, in which “legislatures gave . . . bureaucrats . . . the primary authority to stand guard at the main entrance to the sector and to monitor organizational changes to existing groups?” (p. 5). Did the bureaucrats in these states seek to expand their authority in the way judges did in the states of judicial rule? Were they given — or did they obtain — the stark levels of discretion that judges came to use in those states? And did any excesses of their exercise of authority contribute to the collapse of the system of authorizing judges and state officials, the resulting weakness of state authority (which persists today), and the “relocation of these efforts to the Internal Revenue Service” (p. 5)?

If executive branch officials in other states expressed the same stereotypes and political views as did New York and Pennsylvania judges, the record provided in Silber’s volume fails to prove the breadth of that notion. Did state-level executive branch officials judge nonprofit applications based on “personal reservations — religious, political, class, culture, racial, and social . . .” (p. 5)? And if they did, were they able, as a legal matter, to “[hold] onto a discretion . . . so strong” that their biases “were sufficient to sanction disapproval” (p. 5)? This direction for research is clearly drawn by Silber’s volume,

11. Pp. 40-41 (quoting *In re Lithuanian Workers' Literature Soc'y*, 196 A.D. 262, 267 (N.Y. App. Div. 1921)).

12. P. 47 (discussing the then-famous case of the Decimo Club and the business activities of its founder, Hugh B. Monjar). See *Southerland v. Decimo Club, Inc.*, 142 A. 786 (Del. Ch. 1928). Silber discusses *Decimo Club* at length. Pp. 42-47.

and is a fertile ground for follow-up work. Silber himself, however, fails to provide a clear answer to these questions.¹³

This long period of official state judicial and executive dominance in the nonprofit chartering and monitoring process ended in the 1950s under scrutiny from young members of the legal community. “Assailing the common law tradition, these revisionists utterly routed the discretionary tradition. Within less than a decade . . . judicial discretion . . . had been recast and converted into an improper judicial usurpation that spurned newly cherished legal values” (p. 6). A series of law review notes and other articles, inspired by legal realism, led the way, along with cases in the civil rights arena.¹⁴ By the early 1960s, the discretionary tradition had been severely limited, rendering approval of new nonprofits a virtual entitlement.¹⁵

Since the decline of the discretionary tradition, registration of nonprofits has become largely ministerial at the state level. This has placed greater emphasis on monitoring and enforcement of nonprofits, a task usually sited by state statute in offices of attorneys general and secretaries of state. Active monitoring and enforcement of nonprofits is rare in some states, episodic in others, and reasonably well-engaged in a few. Inconsistency remains the hallmark of state action, both across and within states.

That this history has led to a certain awkwardness in the state regulation of nonprofits has long been clear. Writing in the early 1960s, Kenneth Karst noted the relative weakness and inconsistency of state regulation, a legacy of a perhaps over-aggressive earlier chartering enforcement and state and nonprofit ambivalence toward nonprofit regulation. Karst proposed an alternative — state charities commissions based loosely on an English model¹⁶ — as a response to

13. Silber cites three states — Iowa, Massachusetts, and Mississippi — in which legislative or executive branch officials retained control over nonprofit incorporation. At least one Iowa case continues to stand for the fairly expansive proposition that the state non-profit formation statute (then Iowa Code § 504.1) conferred substantial interpretive and decision authority on executive branch officials rather than merely “ministerial” tasks. See *Iowa v. All-Iowa Agric. Ass’n*, 48 N.W.2d 281 (Iowa 1951); *Iowa v. Civic Action Comm.*, 28 N.W.2d 467 (Iowa 1947) (upholding grant of non-profit charter to political organization).

14. Chapter 4 of Silber’s volume, *The Corrosion of the Discretionary Conception*, pp. 83-126, discusses the downfall of the discretionary tradition in useful detail.

15. But, of course, the judges did not give way quite so easily, as Silber also explains. Even into the 1970s, the judiciary was still trying to regulate the chartering process in particular cases. See pp. 130-31.

16. For more detailed information on the supervisory role of the English Charity Commission, see ELIZABETH CAIRNS, *CHARITIES: LAW AND PRACTICE* (4th ed. 1997), and James Randolph Michels, *U.K. Charity Law: Is it Creating a True Democracy of Giving?* 34 *VAND. J. TRANSNAT’L L.* 169 (2001). Martin Knapp and Jeremy Kendall provide some indication of the failure of the Commission to live up to its expectations, especially since the Nathan Report of 1952. Martin Knapp & Jeremy Kendall, *Policy Issues for the UK Voluntary Sector in the 1990s*, in *THE NONPROFIT SECTOR IN THE MIXED ECONOMY* 221 (Avner Ben-Ner & Benedetto Gui eds., 1993). Evelyn Brody critiques the American reliance on the charity commission model. Evelyn Brody, *Institutional Dissonance in the Nonprofit Sector*,

the insufficiencies of state judicial and executive administration.¹⁷ And others in the intervening years have proposed alternate ways to effectively monitor nonprofits and enforce state statutes governing them without returning to the prejudice and inconsistency of the discretionary era.¹⁸

II. BEYOND THE DISCRETIONARY TRADITION: TOWARD A NEW STATE ACTIVISM IN NONPROFIT MONITORING AND ENFORCEMENT

Developments since Karst's well-known article have perhaps reduced some of the perceived advantages of English-style charity commissions as a rough model for American charity regulation.¹⁹ Similarly, other proposed models of monitoring and enforcement failed to take hold, while structures of self-regulation and accountability within the nonprofit and philanthropic sectors remain weak. The awkward, inconsistent nature of state regulation of the nonprofit sector remains as intractable a problem as when Karst and others identified it some thirty years ago. In removing judicial bias and moving toward the twin systems of federal tax regulation and state corporate and trust regulation, nonprofits are often not effectively monitored or regulated by either system, leading to contradictory patterns of under-regulation, over-regulation, and appropriate action, to a lack of ongoing monitoring, and occasionally to bursts of activity when specific issues arise. The migration of discretion, in Silber's useful phrase, has continued from the 1950s to this day.²⁰

Several examples indicate the complex, perhaps contradictory nature of state regulation today. All come from New York, the core of Silber's exploration of the stages of nonprofit regulation and to this day a key laboratory for state-level monitoring of nonprofits. It is no

41 VILL. L. REV. 433 (1996). For discussion of the utility of the English approach in the Canadian context, see Deborah J. Lewis, *A Principled Approach to the Law of Charities in the Face of Analogies, Activities and the Advancement of Education*, 25 QUEEN'S L.J. 679 (2000).

17. Kenneth L. Karst, *The Efficiency of the Charitable Dollar: An Unfulfilled State Responsibility*, 73 HARV. L. REV. 433 (1960).

18. For review and useful discussion of competing proposals, see, for example, Brody, *supra* note 16.

19. See Brody, *supra* note 16; Knapp & Kendall, *supra* note 16.

20. P. 136. In New York, discretion migrated from judges to administrative authorities responsible for approvals. Pp. 136-38. An example of the sometimes wildly erratic nature of state oversight of nonprofits occurs in the regulation of fundraising, as my colleague Richard Koontz points out, where state action ranges from the largely nonexistent to the occasionally intrusive. For earlier discussion, see, for example, Leslie G. Espinoza, *Straining the Quality of Mercy: Abandoning the Quest for Informed Charitable Giving*, 64 S. CAL. L. REV. 605 (1991); Ellen Harris et al., *Fundraising Into the 1990s: State Regulation of Charitable Solicitation After Riley*, in 1 TOPICS IN PHILANTHROPY 1 (1989). For a recent problem in this area, see Melissa G. Liazos, *Can States Impose Registration Requirements on Online Charitable Solicitors?* 67 U. CHI. L. REV. 1379 (2000).

accident that New York is the primary laboratory for Silber's volume and remains a key subject for study of state monitoring of nonprofits today. At the executive level, the New York State Attorney General, empowered and obligated by law to oversee nonprofits,²¹ has remained active in the nonprofit arena, both in formal monitoring and enforcement and in its less formal varieties. If New York was a pioneer in judicial discretion over the nonprofit registration process, it is perhaps not surprising that it has also been a pioneer in state responses to the weaknesses and inconsistencies of the post-discretionary era. The New York Attorney General has, in recent decades and particularly in recent years, sought to exercise closer and more public oversight of the nonprofit sector in the absence of other realistic alternatives in the post-discretionary era and in the midst of rapid growth of the sector.²²

That oversight includes regular monitoring, informal but strong pressure on certain nonprofits to reform or alter inappropriate practices, with the threat of judicial action looming in the background; formal action to intervene in certain cases; and attempts to expand the recognized scope of the Attorney General's jurisdiction into new areas. In some cases it has been effective, in some cases highly problematic.

21. In New York, the role of the Attorney General is stipulated in the New York Not-For-Profit Corporation Law and the New York Estates, Powers and Trusts Law, among other statutes. For the New York Attorney General's position on these powers, as well as an extensive review of Attorney General power under specific sections of each statute, see Nathan M. Courtney & James G. Siegal, *The Regulatory Role of the Attorney General's Charities Bureau*, at www.oag.state.ny.us/charities/role.html [hereinafter *The Regulatory Role*].

22. The New York State Attorney General has statutory authority to oversee and regulate the nonprofit sector under the New York Not-For-Profit Corporation Law, including authority over a wide range of nonprofit corporate changes. See *The Regulatory Role*, *supra* note 21, at 1. The Attorney General's office also claims that "[t]he Attorney General's supervisory authority over charities is rooted in the common law of charitable trusts and corporations, as well as the *parens patriae* power of the state to protect the interest of the public in assets pledged to public purposes." *Id.*

The Attorney General's authority to oversee the administration of charitable assets in New York State, "representing the interests of beneficiaries of charitable dispositions and enforcing laws governing the conduct of fiduciaries of charitable estates," is also derived from the New York Estates, Powers and Trusts Law. *Id.* According to the Attorney General, its roles in the oversight of conduct of fiduciaries of charitable assets include "broad statutory authority to prosecute and defend legal actions to protect the interests of the State and the public" under the New York State Executive Law, authority under the Estates, Powers and Trusts Law to "investigate transactions and relationships of trustees for the purpose of determining whether or not property held for charitable purposes has been and is being properly administered" (EPTL § 8-1.4(i)), the power to issue subpoenas and the EPTL and the Executive Law, and the power to "institute appropriate proceedings to secure compliance with this section and to secure the proper administration of any trust, corporation, or other relationship to which this section applies" (EPTL § 8-1.4(m)). *Id.* at 2.

III. THE AMBIGUOUS RESURGENCE OF OVERSIGHT: WALLACE-READER'S DIGEST AND THE INFORMAL USES OF STATE POWER

The New York dispute over the disposition of controlled gifts from the Wallace-Reader's Digest Funds is a modern illustration of the important but occasionally less formal role of state regulatory authorities in the nonprofit arena. The Wallace-Reader's Digest dispute arose out of the special context of earlier gifts by the Wallace family to thirteen elite cultural, environmental, and academic institutions close to the philanthropic interest of the founders of Reader's Digest, DeWitt and Lila Wallace, and their advisors.²³ In the 1980s, before DeWitt and Lila Wallace died, they made substantial bequests to those thirteen organizations in a complex and unusual form.²⁴

The bequests stipulated that the donated funds would be managed by seven "supporting organizations" rather than by the beneficiaries themselves. The "supporting organizations" were largely controlled by the Wallace-Reader's Digest Funds and Reader's Digest and the assets of the seven supporting organizations were substantially invested in Reader's Digest stock. This caused a rift between Wallace-Reader's Digest and the institutional beneficiaries. As the *New York Times* explained,

[t]he endowment funds, heavily invested in Reader's Digest stock, were administered for the recipients by seven organizations under restrictions that impeded the selling of Digest stock. The [value of the Reader's Digest] shares plummeted in the 1990's as the stock market took off, but the arrangement buttressed the Reader's Digest at a turbulent time. The recipient groups, however, could only watch as they missed better investment opportunities.²⁵

23. Specifically, the Wallace-Reader's Digest Funds beneficiaries were the Metropolitan Museum of Art, the Colonial Williamsburg Foundation, the Open Space Institute, Scenic Hudson, the Memorial Sloan-Kettering Cancer Center, the Metropolitan Opera, the New York City Ballet, the Vivian Beaumont Theater, the New York City Opera, the Philharmonic Symphony Society of New York, the Chamber Music Society of New York, Macalester College in St. Paul, Minnesota, and the Wildlife Conservation Society in New York.

24. The Wallace-Reader's Digest dispute is discussed in Ralph Blumenthal, *13 Institutions Obtain Control of Vast Bequest*, N.Y. TIMES, May 4, 2001, at A1. For an account of a senior attorney in the Attorney General's office discussing the Wallace-Reader's Digest dispute, see William Josephson, *Guiding Practitioners and Fiduciaries on Charities*, N.Y.L.J., Dec. 3, 2001, at 1. See also Janet L. Fix, *Wallace-Reader's Digest Funds and N.Y. Attorney General Reach Settlement*, CHRON. OF PHILANTHROPY, May 17, 2001, at 13. For an earlier treatment focusing on the shareholder dissatisfaction with the declining price of Reader's Digest stock, see Geraldine Fabrikant, *Faith Ebbs on Reader's Digest Stock*, N.Y. TIMES, Jan. 16, 1998, at D1, and Geraldine Fabrikant, *Reader's Digest Gives the Arts a Lesson in Finance*, N.Y. TIMES, Aug. 26, 1997, at A1. Dueling statements by the Wallace-Reader's Digest Funds and by the New York Attorney General are cited *infra* notes 30-31.

25. See Blumenthal, *supra* note 24.

According to statistics compiled by the *New York Times*, a number of the beneficiaries lost money on the portion of the Wallace bequest that was controlled by the intermediate “supporting organizations.” But the cultural institutions profited on the portion of the Wallace bequest that they themselves controlled and diversified. At the end of fiscal year 1997, for example, the Metropolitan Museum of Art’s total share of the Wallace bequest was \$370.2 million. Of that, \$196.3 million was controlled by a Digest supporting organization and held in Digest stock, and that portion of the portfolio had declined in value by 17% since the end of 1991. The other \$173.9 million of the bequest — including dividends on the Digest stock — was controlled directly by the Museum and invested in a more diversified manner; in that six-year period it appreciated 47.8%. Lincoln Center’s²⁶ experience was similar: in the same time period it lost 17% on the portion of the portfolio controlled by a Digest supporting organization and held in Digest stock, and gained 23.9% on the portion of the gift that it controlled.²⁷

The New York State Attorney General’s office joined this complex and confusing fray in 1998, when it learned that some of the ultimate institutional beneficiaries (most of whom were based in New York State) were concerned that the Digest-influenced supporting organizations had declined to diversify holdings away from weak Digest stock despite some institutions’ desire to diversify. The Attorney General’s office was concerned primarily about potential conflicts of interest in the decisionmaking involving supporting organizations that were heavily influenced by the Wallace-Reader’s Digest Funds and the management of Reader’s Digest, because under New York law charitable fiduciaries are required to administer charitable funds for the benefit of recipients rather than for other purposes. One corporate watchdog and Digest investor put the problem in fairly blunt terms:

[M]y concerns were [that] there were tremendous conflicts of interest inherent in the foundation [Wallace-Reader’s Digest Funds] and the company [Reader’s Digest]. The company was making decisions for the benefit of the foundation and the foundation was making decisions for

26. The Lincoln Center organizations included in the Wallace-Readers Digest settlement included the Metropolitan Opera (receiving approximately \$92 million); New York City Ballet (\$65 million); Vivian Beaumont Theater (\$59 million); New York City Opera (\$59 million); Philharmonic Symphony Society of New York (\$26 million); and the Chamber Music Society of New York (\$13 million). Ralph Blumenthal, *Institutions Finally Gain Control of Large Reader’s Digest Bequest*, N.Y. TIMES, May 4, 2001, at A1.

27. Of the seven organizations profiled by the *New York Times*, only one appeared to have lost money both on the portfolio controlled by a Digest supporting organization and held in Digest stock, and on the portfolio (including Digest stock dividends) that it controlled itself. That was Memorial Sloan-Kettering Cancer Center, which lost 51.2% in the 1991-1997 timeframe on the Digest-controlled portfolio and lost 16.1% on the portfolio it controlled. *Id.*

the benefit of the company and no one was making decisions for the benefit of the outside shareholders.²⁸

The Attorney General appears to have strongly but informally urged the parties to come to a settlement and reportedly threatened subpoenas and a lawsuit.²⁹ That pressure seems to have had the same effect. The Wallace-Reader's Digest Funds announced in May 2001 that \$1.7 billion would be transferred from control of the supporting organizations to control by the thirteen ultimate institutional beneficiaries, the Metropolitan Museum of Art and the others.³⁰ The shift was announced not as a written agreement between the New York State Attorney General and the Wallace-Reader's Digest Funds, but in separate press releases from each party, and press reports in which the two sides issued overlapping but not equivalent — and not particularly friendly — comments.³¹ The New York Attorney General's statement emphasized the shift as an "agreement" between the Funds and the Attorney General's office that "resolv[ed] concerns expressed by [Attorney General] Spitzer's office."³² The Attorney General announced "an historic agreement" in which

upon the recommendation of the Wallace-Reader's Digest Funds, the [seven Wallace] Supporting Organizations [established to benefit the thirteen institutional recipients] will be dissolved and all of their assets, which include both Reader's Digest stock and other, diversified holdings, will be transferred to the 13 charities so that they will now be able to directly manage their own assets in a manner consistent with the wishes of

28. Blumenthal, *supra* note 26.

29. See *id.*; Ann Marie Chaker, *Reader's Digest Funds Revamp, Give Control of Assets to Charities*, WALL ST. J., May 4, 2001, at B4; Katia Hetter, *Reader's Digest Deal Benefits Groups*, NEWSDAY, May 4, 2001, at A59.

30. The Reader's Digest statement, *Wallace Funds Transfer \$1.7 Billion to 13 Charitable Institutions*, can be found at <http://www.wallacefunds.org/newsroom>. The Metropolitan Museum of Art received \$424 million, Macalester College \$303 million, the Wildlife Conservation Society \$191 million, Colonial Williamsburg Foundation \$155 million, the Open Space Institute \$115 million, Scenic Hudson Inc. \$115 million, Memorial Sloan Kettering Cancer Center \$100 million, Metropolitan Opera Association \$92 million, New York City Ballet \$65 million, Vivian Beaumont Theater \$59 million, New York City Opera \$59 million, Philharmonic Symphony Society of New York \$26 million, and the Chamber Music Society of New York \$13 million. The agreements stipulated that each recipient would "place these assets in a newly-created endowment fund named for the Wallaces. Income from the endowments will be devoted to projects consistent with the wishes of the founding donors and the historical practices of the supporting organizations." *Id.*

31. For the Attorney General's statement, see Spitzer Announces Resolution Involving \$3.2 Billion Legacy Left by Founders of Reader's Digest; 13 Major Charities Including the Met, Sloan-Kettering, Colonial Williamsburg, Will Now Control Own Funds; Reorganization Also Includes New, Independent Board for Wallace-Reader's Digest Foundation [hereinafter New York Attorney General May 4 statement], at http://www.oag.state.ny.us/press/2001/may/may04a_01.html.

32. New York Attorney General May 4 statement, *supra* note 31.

the Wallaces and the historical practices of the Wallace Supporting Organizations.³³

The Attorney General's concerns had gone beyond control over a charitable beneficiary's invested funds to a concern for Reader's Digest's control over the investments and practices of the Wallace-Reader's Digest Funds. The Attorney General thus also announced that "the Wallace Funds, which hold a 50% share of Reader's Digest voting stock, have taken steps to modernize their governing structure, resolving concerns expressed by Spitzer's office. The new corporate structure, implemented by the foundations two months ago, is designed to ensure fully independent decision making, particularly when it comes to investment decisions."³⁴ Attorney General Spitzer emphasized that "these steps will help ensure the long-term health and viability of the Wallaces' bequest and benefit the arts, cultural, medical, environmental and historic preservation communities for generations to come," closing with a swipe at the practices of the Wallace Funds and the supporting organizations: "This divestiture by the Supporting Organizations moves the Wallaces' bequest into the 21st century with a sound investment strategy."³⁵

Wallace-Reader's Digest may have resisted pressure to transfer control over the bequests to the recipient groups and may have resisted criticism of the interlocking structure of the company, Funds, and supporting organizations. Likewise it appears that the pressure applied by two New York Attorneys General — first Dennis Vacco, then Eliot Spitzer — played a substantial role in urging Wallace-Reader's Digest to bend on both counts. The Attorney General's inquiry and pressure was apparently central to accelerating the negotiations that took place, and to the settlement that resulted. And, in this case, an informal process seems to have produced the right result in philanthropic terms. But it is also clear that these informal, pressuring processes were the only means to resolve an increasingly knotty problem of conflicted interests and philanthropic capital short of for-

33. *Id.*

34. *Id.*

35. *Id.* Comments by the recipient groups — some of which had complained earlier of investment and Reader's Digest stock sale restrictions — were considerably more muted, as the recipients tried to antagonize neither the Wallace Funds nor the Attorney General. The President of the Metropolitan Museum allowed the Attorney General's office to issue a bland statement that "[a]lthough this agreement provides no new funding to the Metropolitan, it does give it the ability to directly oversee this investment. In this way, the institution will continue to carry Lila Acheson Wallace's legacy into the future." *Id.* The executive director of Scenic Hudson was quoted by the Attorney General's office as saying:

This is great news for Scenic Hudson. It puts us on a firm foundation for the new century and helps ensure the stability of our land-preservation work. The fact that we have been entrusted to manage these resources should give us increased credibility with our funders, whose help we need more than ever.

Id.

mal litigation. The informal processes went forward in an environment in which the philanthropic community itself did not have structures of self-regulation and accountability in place to resolve such issues before a regulatory authority became involved in its informal capacities, threatening more formal action.

IV. THE AMBIGUOUS EXTENSION OF OVERSIGHT: NEW YORK COMMUNITY TRUST AND THE FAILED EXPANSION OF STATE POWER

By the 1990s a new form of philanthropy was expanding rapidly throughout the United States. Community foundations — pools of funds donated by, in most cases, local philanthropists, had begun to remake the American philanthropic landscape and to remake traditional relationships between individual donors and charitable causes. By 2000 there were over 500 community foundations and funds in the United States with assets of over \$27 billion — more than double the \$12 billion in assets reported as recently as 1995. Philanthropic donations by American community foundations have quadrupled since 1990.³⁶

Community foundations have built their growth on the logical assumption that pooling philanthropic funds and using those pooled funds in a focused way on local problems may have a faster and deeper impact on local social issues. This concept has enabled community foundations to attract funds through direct donations, without restriction on the application of those funds to local charitable, educational, and other causes. While that form of giving is warmly welcomed by community foundations because it allows the foundations maximum flexibility in grantmaking, many philanthropists restrict the use of their funds to specific organizations, causes, or fields, desiring the administrative convenience, investment management, and philanthropic focus of donating through community foundations but wanting a continuing role in determining where and how their philanthropic dollars will be distributed. Donors that restrict the use of their funds know that a significant feature of community foundations — the key innovation when community foundations were introduced by attorney Frederick Goff in 1913 in Cleveland — will protect the utility of their philanthropy as social needs change. That is the “variance power,” under which donors and community foundations agree that the foundation may redirect a donor’s chosen philanthropy if the original restriction or request is made redundant or impossible due to the passage of time.³⁷ In 1971, the New York Community Trust exercised that

36. The Foundation Center, *Foundation Growth and Giving Estimates 2001*, at <http://www.fdncenter.org/research>.

37. The variance power of community foundations has often been analogized to *cy pres*, the power of a court to order a change in purpose in a charitable trust or other instrument.

variance power with respect to six trusts created decades earlier, directing grants away from a major New York social service organization, the Community Service Society, and toward more flexible grant-making. The Community Service Society's challenge of that action in the 1990s marked the first significant judicial challenge to the use of the variance power by community foundations, and brought the New York Attorney General into the fray.³⁸

In the 1940s, Laura Spelman Rockefeller and other committed New York philanthropists made bequests to the New York Community Trust for the benefit of the Community Service Society, a private, charitable New York agency that has served the city's poor since the mid-nineteenth century. When Rockefeller and the others made their bequests, they and the New York Community Trust signed a trust resolution which provided that the Community Trust would deliver the income from the invested bequests to the Community Service Society, but that the Community Trust might also vary the disposition of her bequest from her specific intention. In the words of the trust resolution,

any such expressed desire of the donor shall be respected and observed, subject, however, in every case to the condition that if and whenever it shall appear to the Distribution Committee [of the Community Trust] . . . that circumstances have so changed since the execution of the instrument containing any gift, grant, devise or bequest as to render unnecessary, undesirable, impractical or impossible a literal compliance with the terms of such instrument, such Committee may at any time or from time to time direct the application of such gift, grant, devise or bequest to such other public educational, charitable or benevolent purpose as, in their judgment, will most effectually accomplish the general purpose . . . without regard to and free from any specific restriction limitation or direction contained in such instrument.³⁹

Variance power can be understood as a contractual form of *cy pres* that obviates the need for judicial involvement in acquiescing to and determining a changed or new charitable purpose, and that eliminates the long-standing doctrinal complexities and inflexibilities of *cy pres*. On *cy pres*, see Rob Atkinson, *Reforming Cy Pres Reform*, 44 HASTINGS L.J. 1111 (1993); Edith Fisch, *The Cy Pres Doctrine and Changing Philosophies*, 51 MICH. L. REV. 375 (1953); Alex M. Johnson, Jr., *Limiting Dead Hand Control of Charitable Trusts: Expanding the Use of the Cy Pres Doctrine*, 21 HAW. L. REV. 353 (1999); Alex M. Johnson, Jr. & Ross D. Taylor, *Revolutionizing Judicial Interpretation of Charitable Trusts: Applying Relational Contracts and Dynamic Interpretation to Cy Pres and America's Cup Litigation*, 74 IOWA L. REV. 545 (1989); Roger G. Sisson, *Relaxing the Dead Hand's Grip: Charitable Efficiency and the Doctrine of Cy Pres*, 74 VA. L. REV. 635 (1988).

38. *Cmty. Serv. Soc'y v. N.Y. Cmty. Trust (In re Preiskel)*, 275 A.D.2d 171 (N.Y. App. Div. 2000), *motion for leave to appeal denied*, 751 N.E.2d 940 (N.Y. 2001). This case is described in some detail below given its significance for the regulation of community philanthropy in the United States, and for the future role of state attorneys-general and other state executive authorities in monitoring and reviewing the "variance power" decisions of community foundations and trusts.

39. *Id.* at 174.

For several decades, until the early 1970s, this process worked smoothly. Monies from the Laura Spelman Memorial and the other designated trusts were invested by the New York Community Trust, and on a regular basis income from the invested assets of the designated funds were directed to the Community Service Society in support of its social programs. The situation changed drastically in 1970, when the Community Trust initiated a review of its funding procedures and priorities. The Community Service Society claims that the Community Trust initiated this review, in the words of the appellate court, "to eliminate as much as possible the designated funds and expand Community Trust's discretion with regard to the distribution of funds."⁴⁰ The Community Trust rejected that explanation of its motivations, claiming that "the impetus for the review was the Tax Reform Act of 1969, which made clear that charitable foundations where the donors exercised inordinate control over the distribution of monies ran the risk of losing tax-exempt status."⁴¹

The Community Trust's review of its grants to the Community Service Society also coincided with a program and organizational review by the Community Service Society of its own activities. Deeply affected by the social movements of the late 1960s, the Community Service Society

change[d] how services were provided. Instead of requiring individuals in need of assistance to make an appointment to come to one of its four offices, it was decided to move operations into community groups . . . such as transient hotels, hospital and housing projects . . . [A]ssistance would no longer always be directly provided by [the Community Service Society,] but could be channeled through existing community-based organizations.⁴²

In the words of the New York appellate court, "CSS was to be transformed from a social services agency to one sharing power with community-based organizations."⁴³

As a result of the Community Trust's internal review of its own grantmaking policies, a New York Times article on the changes underway at Community Service Society, and the Society's own internal review,⁴⁴ in March 1971 the Community Trust suspended further pay-

40. *Id.*

41. *Id.*

42. *Id.* at 175.

43. *Id.* In the early 1970s, traditional New York philanthropy was not yet accustomed to working with community-based organizations, especially those working to support empowerment as well as direct services, although it is not altogether clear to what extent this factor played a role in Community Trust's decision to suspend automatic grant payments to the Society. *Id.* at 175-76.

44. The appellate court appears to have believed that the Community Trust's suspension of grants to CSS was based on an article in the *New York Times*, describing the proposed changes at CSS as a "Copernican revolution." When the key Community Trust em-

ments to CSS and in September 1971 formally exercised its variance power to revoke the designated grants program of the six original trusts at a meeting of its Distribution Committee, and altered them to become “ ‘semi-designated fund[s] for the improvement of health and welfare in New York City.’ ”⁴⁵ Automatic grantmaking to Community Service Society ended, though some discretionary grants were still made until at least 1995.⁴⁶

In 1995, Community Service Society filed suit, seeking to compel an accounting of funds invested and distributed from the six trusts between 1928 and 1995, and directing distribution of income from the designated funds. The case came before the New York Surrogate, Eve Preminger, who ruled that the Community Trust had abused its variance power. The Surrogate directed an accounting for the period from 1989 to 1999 calculating New York’s six year statute of limitations for trust accounts from 1995, when the suit was filed. The Surrogate concluded with one of the few tests that courts have ever delineated to guide the exercise of a foundation’s variance power over designated trust funds. A finding of “undesirability” within the meaning of the Community Trust’s trust resolution sufficient to allow the Trust to vary the terms of the bequestor “ ‘must be grounded in a change of circumstance that negatively affects the designated charity to such a degree that it would be likely to prompt a donor of the fund to redirect it.’ ”⁴⁷ Exercise of the variance power will be upheld only where “identifiable negative details” provide evidence of “undesirability” in carrying out the original trust instructions. The actions of a trust in utilizing the variance power will be judged against an “abuse of discretion” standard, and if a trust utilizes that criterion and standard, “the courts must afford its decision maximum deference in review.”⁴⁸

Since Community Trust’s notice of its changing policies to the Society “fell short of conveying to CSS notice of a complete termination of its interests . . . muddl[ing] the message of an otherwise clear

ployee reviewed the CSS study and prepared a report in April 1971, several weeks after the Trust’s Distribution Committee had decided to suspend grants to CSS, she wrote that “ [f]rom this document [the CSS study] it appears unlikely that we could continue to make grants to CSS based on its direct service to individuals. But, if these funds were discretionary rather than designated, we would most likely make grants to CSS based on its excellent program and projects.’ ” *Id.* at 176. (emphasis omitted).

45. *Id.*

46. *Id.* at 177-78. The Community Trust claimed that the decision to exercise its variance power in September 1971 had been clearly communicated at the time to the Society’s Executive Director and Board Chair; CSS denied that such communication had taken place, indicating that it believed, until it was alerted to the contrary by Chemical Bank in 1993, that the grants it had received in the intervening twenty-two years had come from the automatic provisions of the six original trusts.

47. *Id.* at 179.

48. *Id.* at 179-80.

repudiation . . . there was no effective repudiation”⁴⁹ and the six year statute of limitations for trust accountings in New York — which would have barred the Society’s 1995 suit — did not begin to run when the change in funding took place in 1971. Instead, the statute of limitations began to run in 1995, when the action was commenced, and thus the six years prior to the commencement of the proceedings were includable in the accounting ordered.⁵⁰ The parties cross-appealed and the New York Attorney General joined the case, arguing that a community foundation should be required to provide notice to a state executive authority, in this case the Attorney General, when a charitable trust exercises its variance power.⁵¹

The Appellate Court agreed with the Surrogate that the New York Community Trust had abused its variance power to alter the six trusts from designated funds in favor of the Community Service Society to more flexible grantmaking. The Court reiterated that the trusts clearly “intended that CSS receive specific distributions,” and rejected the Community Trust’s claim that a change in circumstances and the policy directions at the Community Service Society made the trust designation “undesirable” under the terms of the wills.

Community Trust, arguably unhappy with mandated allocations, claims that the change in CSS’s approach from being a direct provider to one affiliated with community organizations was an “undesirable” change in circumstances. That distinction . . . appears . . . virtually meaningless, since there is no claim that CSS has retreated from its overriding purpose of servicing the need. As a result, the Surrogate reasonably found that Community Trust abused its discretion, since there is no showing that CSS has deviated from its primary purpose.⁵²

49. *Id.* at 179.

50. *Id.*

51. The Attorney General also argued against the application of the six year statute of limitations period for trust accountings. Brief of Cross-Appellant New York State Attorney General at 44, *In re Laura Spelman Rockefeller Mem’l*, 2000 N.Y. App. Div. LEXIS 2756 (M-269) [hereinafter Attorney General Brief] (on file with author).

52. *N.Y. Cmty. Trust*, 275 A.D.2d at 182. The Appellate Court upheld the Surrogate’s decision that community foundations must make a “finding” before utilizing the variance power, and that the actions of a trust in exercising the power must be judged against an “abuse of discretion” standard, and affirmed the Surrogate’s use of each standard. The Court also upheld the Surrogate’s substantive standard for judging the exercise of variance powers in “undesirability” cases, restating the restrictiveness of the test, arguably in even stronger and broader terms favoring the designated charities, for future cases.

The Surrogate’s conclusion, that exercise of the variance power should be limited to those situations where “identifiable negative details” may be offered to substantiate the “undesirability” of continued payments, appears to be an equitable and definable standard. Thus, in a given case, if it were shown that the designated charity, for whatever reason, was no longer carrying out its stated purpose, then a finding of undesirability might be made. Here, however, while designated funding of community-based approaches might be undesirable from the Trust’s viewpoint, it cannot be said that such an approach compromises the intention of the trust creators, which is the determinative factor.

Id. at 182-83.

Thus on the question of appropriate use of the variance power, the appellate court found, with the Surrogate, that the Community Trust had misused the variance power in transforming the six trusts from designated funds to flexible grantmaking sources. But the appellate court also disagreed with the Surrogate's finding that the Community Trust's repudiation was not absolute, thus that the six year New York statute of limitations had not begun to run in 1971. Citing the record of contacts between the Community Trust and the Society, the understandings of the Society's then General Director, and a history of over twenty years of grant applications after 1971, the appellate court found that clear repudiation had been conveyed from the Community Trust to the Society. Having ruled that repudiation was effective in 1971, the New York State six year statute of limitations began to run at that time, time-barring the action initiated in 1995.⁵³

The Attorney General's intervention in the dispute, as counsel for the "ultimate charitable beneficiaries" of the action, was perhaps the least noticed element in a case that has significant ramifications for American community philanthropy. The Attorney General argued that the Court "should impose an affirmative requirement for effective notice to the Attorney General, to ensure that the basic fairness inherent in judicial proceedings is not absent from the unilateral variance power's extrajudicial alternative,"⁵⁴ citing its inherent powers under New York's Estates, Powers and Trusts Law and the Not-for-Profit Corporation Law. The Appellate Division rather curtly declined to expand the Attorney General's powers in that fashion:

In this case . . . Community Trust explicitly possessed the variance power pursuant to the terms of the Trust Resolution. While nothing prevented it from notifying the Attorney General, there is no requirement at law to do so. Furthermore, while unnamed individuals might ultimately be the beneficiaries of the funds channeled to CSS by Community Trust, the fact remains that the designated recipient under the trusts at issue was CSS, to which Community Trust gave notice. In the absence of a specific requirement, this Court declines to impose one The Attorney General's request that this Court craft a notice requirement would be better directed to the Legislature.⁵⁵

Here, too, was a vacuum that a new form of state activism was seeking to fill, in this case through judicial means. If a community foundation or trust is to exercise its "variance power," and if its notice to the original beneficiary is ambiguous, as arguably occurred in *New*

53. A broad statement seemed to apply both to the pre-1995 and the post-1995 claims: "[A]ll of [the Society's] claims are time-barred, since there does not appear to be any reason to distinguish between the more recent claims, and those in the prior years. Either CSS had notice of the repudiation or it did not. Since it clearly did, its claims . . . should be dismissed." *Id.* at 185.

54. Attorney General Brief, *supra* note 51, at 28.

55. *N.Y. Cmty. Trust*, 275 A.D.2d at 186.

York Community Trust, then the Attorney General should at least have the opportunity to be put on notice and monitor the variance exercise. Here, too, the Attorney General steps in to craft a role because there appears — without litigation as in *New York Community Trust* — to be no other effective way to monitor such activities. In effect the New York judiciary rebuffs the Attorney General's attempt to fashion a regulatory role in what is, at root, a contractual relationship, viewing judicial processes as sufficient guard against improper action and inviting the Attorney General to approach the legislature if it disagrees.

In addition to these recent examples, the New York Attorney General has undertaken other highly prominent activity to monitor nonprofits and enforce New York's nonprofit corporation and trusts law. The Attorney General played a central role in exposing alleged malfeasance at Hale House, a child relief center that has been one of New York's most prominent charities.⁵⁶ The Attorney General was actively involved in investigations and attempts to decertify the fundraising and spending activities of a Muslim charity, the Holy Land Foundation for Relief and Development, on the grounds that the organization had ties to Hamas, undertaken well before the federal government banned some of the group's banking activities after the tragic events of September 11, 2001.⁵⁷

56. See Nina Bernstein, *Officials Overlooked Dire Signs at Charity*, N.Y. TIMES, Feb. 7, 2002, at B1; Terry Pristin, *Facing Scrutiny, President of Hale House Will Resign*, N.Y. TIMES, May 8, 2001, at B3.

57. In early June 2001, the Attorney General initiated proceedings in state Supreme Court to compel the Foundation to disclose its fundraising techniques, donors, recipients of Foundation funds, and any pending lawsuits against the Foundation. See *Muslim Fund Inquiry is Pressed*, N.Y. TIMES, June 1, 2001, at A19; *Spitzer Seeks Data on Mideast Charity*, NEWSDAY, June 1, 2001, at A52. Spitzer's office said that the Foundation had ignored a September 2000 subpoena that requested documents on fundraising and federal tax filings. See *id.*

The U.S. Justice and State Departments launched investigations of the Holy Land Foundation in the mid-1990s, focusing on alleged ties between the Foundation and Hamas, and leading to pre-September 11 discussions of placing the Holy Land Foundation on a list of terrorist organizations under a 1995 Presidential executive order requiring the Treasury Department, through the Office of Foreign Assets Control ("OFAC"), to seize organizational and institutional assets that are determined to pose a threat to the peace process in the Middle East. See, e.g., *Richardson-based Foundation Has Been Subject of 4-Year Inquiry*, DALLAS MORNING NEWS, Feb. 13, 2000, at 1A. Israel closed the Holy Land Foundation's Israel operations in May 1997 (along with four other charities), declaring it to be a front for Hamas. In August 2000, the State Department requested that the U.S. Agency for International Development ("USAID") withdraw the Foundation's listing on a roster of charities and relief organizations eligible for USAID funding for relief work abroad, and USAID in turn asked the State Department for evidence of the Foundation's links to Hamas. See Bob Mahlburg & Bechetta Jackson, *Area Muslims Defend Charity Group*, FORT WORTH STAR-TELEGRAM, Aug. 26, 2000, at 10B; Judith Miller, *U.S. Contends Muslim Charity Is Tied to Hamas*, N.Y. TIMES, Aug. 25, 2000, at A21; *Muslim Charity Tied to Terrorists*, U.S. SAYS, ARIZ. REPUBLIC, Aug. 25, 2000.

American Airlines and Citigroup, among other U.S. firms, were asked before September 11 to cut or reduce business ties with the Holy Land Foundation. See Janine Zacharia, *Hamas denies it receives money via Citibank*, JERUSALEM POST, Jan. 26 2001, at A6. The Foundation raised about \$6.6 million in 1999, and describes its work at <http://www.hlf.org>.

The Attorney General also played an active role in the now well-known dispute involving trustees and the president of Adelphi University, in which the trustees were removed for neglect of fiduciary obligations in approving excessive compensation for its then-President, with the Attorney General's office seeking to establish "causes of action against the former president for breach of fiduciary duty and against the university's trustees for [state-paid] legal fees."⁵⁸ The Attorney General's office also played an active role in state-level enforcement of corporate reforms at the United Way following allegations of "misappropriation and mismanagement of charitable funds" in the early 1990s, and in suing several United Way officers for losses suffered as a result of the misappropriated funds.⁵⁹

The new state activism in nonprofit monitoring, at least in New York, has extended beyond these cases and well beyond the judicial arena as well. Attorney General Spitzer and his staff have publicly advised New York nonprofits on the use of investment profits from nonprofit endowments, warning nonprofits that "endowment fund appreciation cannot be expended unless the governing board appropriates the appreciation prudently,"⁶⁰ relying on the New York Not-for-Profit Corporation Law, and advised governing boards to hold full deliberations and votes on the appropriation of endowment appreciation rather than devolving those decisions entirely to nonprofit executives or family members.⁶¹ The Attorney General's office issues annual reports on the activities of fundraisers registered in New York State,⁶² has published guidelines for directors of nonprofit boards and instructions for nonprofits conducting raffles in New York,⁶³ and warned on quorum requirements for religious corporations undertaking transactions in real property,⁶⁴ among other actions.

After the September 11 attacks, the Holy Land Foundation was added to the OFAC proscribed list.

58. *Vacco v. Diamandopoulos*, 715 N.Y.S.2d 269 (Sup. Ct. 1998), discussed in *The Regulatory Role*, *supra* note 21, at 5.

59. See *Former Corporate Officers Are Liable for Misappropriating Charity Money*, N.Y.L.J., Aug. 7, 1998, at 21 (reporting decision in *Vacco v. Aramony*, discussed in *The Regulatory Role*, *supra* note 21, at 5-6).

60. *News from the Charities Bureau: New York State Attorney General Eliot Spitzer Advises Not-For-Profit Corporations on the Appropriation of Endowment Fund Appreciation*, at <http://www.oag.state.ny.us/charities/news/endowment.html>.

61. *Id.*

62. *Pennies for Charities: The Attorney General's Report on Fund Raisers in New York*, at <http://www.oag.state.ny.us/charities/charities.html>.

63. *Information for Charitable Organizations Conducting Raffles in New York State*, at <http://www.oag.state.ny.us/charities/news/brochure-2-28-01.html>.

64. *Charities Bureau Update: Quorum Requirement for Religious Corporations in Real Property Transactions*, at <http://www.oag.state.ny.us/charities/news/quorum.html>.

While Wallace-Reader's Digest and *New York Community Trust* were finally resolved after *A Corporate Form of Freedom* went to press, many of the themes that emerge in those disputes are mirrored in Silber's interpretation of the post-discretionary problems of non-profit monitoring and enforcement. If "[t]he substitute that the student law review commentators offered to diminish scrutiny of non-profit purposes was a more aggressive and ongoing scrutiny *after* nonprofit associations became corporate" (marked by mandatory disclosure and enhanced state enforcement and federal tax scrutiny), "[n]one of these turned out to be sufficiently effective."⁶⁵ And into that partial vacuum, at least in New York, bolstered by substantial statutory oversight authority, has moved the Attorney General, expanding his scrutiny to include both informal but powerful attempts to bring philanthropies to heel in the Wallace-Reader's Digest episode, and an attempt to extend its statutory range into new areas, as in the notification and review of the exercise of the variance power.

Attempts to migrate oversight, monitoring and enforcement are arguably undertaken with even more vigor in times of crisis, when the traditional patterns of oversight and coordination appear particularly weak. This occurred after September 2001, when dozens of philanthropic and charitable organizations sought to provide assistance to the direct and indirect victims, individuals and organizations, of the attacks on the World Trade Center. As hundreds of millions of dollars in aid became available, but implementation appeared to begin in a chaotic fashion, the New York Attorney General stepped in to claim a role in the coordination of that assistance.⁶⁶ Eventually a data bank of victims and available aid emerged in which the Attorney General has a significant role,⁶⁷ and the Attorney General has played a prominent role in providing commentary on the September attacks.⁶⁸

There appears to be no end to this ongoing struggle for discretion and authority, especially when nonprofits are increasingly in the news and when states and citizens appear increasingly concerned that the oversight of nonprofits has fallen through regulatory cracks. The new state activism as typified by the New York disputes seems inevitable

65. P. 146. Silber outlines the failures of mandatory disclosure and enhanced state enforcement and federal tax scrutiny. Pp. 146-59.

66. See, e.g., David Barstow, *\$850 Million for Charity, Not Centrally Monitored*, N.Y. TIMES, Oct. 11, 2001, at B1; *Spending Is the Hard Part*, N.Y. TIMES, Oct. 5, 2001, at A26.

67. See *A Fair Shake for Victims*, N.Y. TIMES, Dec. 23, 2001, § 4, at 8; *Collaborative Charity*, N.Y. TIMES, Oct. 15, 2001, at A18.

68. See Diana B. Henriques & David Barstow, *Victims' Fund Likely to Pay Average of \$1.6 Million Each*, N.Y. TIMES, Dec. 21, 2001, at A1; Testimony of New York State Attorney General Eliot Spitzer before the House Committee on Energy and Commerce, Subcommittee on Oversight and Investigations, Nov. 6, 2001, at <http://www.oag.stat.ny.us/press/statements/reliefnov11.html>. The Attorney General's comments on the federal fund are available at <http://www.oag.state.ny.us/wtcl/>.

given the growth in size and complexity of the sector, the historic migration of authority over the sector from judiciary to executive, and the failure of the sector — perhaps particularly its philanthropic component — to evolve effective means and structures of self-regulation and accountability. Silber's volume gives us the historical background to these contemporary struggles in ways that resonate clearly as debates on discretion, oversight, and authority over the nonprofit sector continue to emerge.

Five analytical and policy approaches to these problems of oversight and accountability in the nonprofit sector have had some prominence. Oversight through the Internal Revenue Service remains problematic for any role except the direct tax consequences of nonprofit activity — and even inconsistent in that arena as well.⁶⁹ The potential for state-level charity commissions has been bruited since Karst's well-known article, but adherence to that approach has faded over the years as the complications of organizing charity commissions has become evident, and the issues in the English model have become more clear. A third approach, press exposure of the failings of the nonprofit sector, is a useful supplementary tool to strengthen accountability. But press reporting on nonprofit failings tends to focus more on the outrageous cases than on structural or widespread problems, and, except in scandalous cases, tends to be short-lived.⁷⁰

Given the weaknesses of these approaches, two others are on the rise. One relies on nonprofits themselves, not primarily on the oversight power of the states or the federal government, or the role of the press. Increasingly the nonprofit community is paying attention to strengthening self-regulation within its own arena. The nascent self-regulatory efforts underway include strengthening of the roles and capacities of nonprofit boards, enhancement of internal regulatory standards (including codes of conduct, standards, and principles), nascent attempts at formalizing accreditation of nonprofits in specific geographic areas or functional areas of work, improving the regulatory ef-

69. A recent General Accounting Office report reiterates this point. See U.S. GENERAL ACCOUNTING OFFICE, TAX EXEMPT ORGANIZATIONS: IMPROVEMENTS POSSIBLE IN PUBLIC, IRS, AND STATE OVERSIGHT OF CHARITIES, GAO 02-526 (Apr. 2002); Harry Lipman, *IRS Oversight Lacking, Draft Report Says*, CHRON. OF PHILANTHROPY, May 2, 2002, at 36.

70. I am indebted to my colleague Sandy Boyd for discussion of this point. As Joel Fleishman has noted:

[A]most invariably, the press presents a picture badly out of focus, one that is unnecessarily alarming to the public, and even worse, that frequently undermines the public's confidence in the possibility of effective action. The result . . . is to create an atmosphere of hysteria which can sometimes lead to throwing out the baby with the bath.

Fleishman, *quoted in* Robert Bothwell, *Trends in Self-Regulation and Transparency of Non-profit Organizations in the U.S.*, INT'L J. NONPROFIT L. (Sept. 2001), at www.icnl.org/journal/journal.htm.

forts of non-governmental “watchdog” organizations, and strengthening organizational disclosure and transparency.⁷¹

Some of these efforts rely on government regulatory impetus, such as public disclosure requirements for nonprofit tax documents. Most rely on nascent and conflictual attempts to try to build a sort of internal law for the nonprofit sector, one that both helps govern the arena and protect it from external criticism and additional oversight. Self-regulation has become something of a watchword in the nonprofit community, both in the United States and abroad. Finding ways of effectively implementing self-regulatory structures has, however, long been a problem for the nonprofit sector, and despite the active and committed efforts to strengthen self-regulation in recent years serious questions remain as to whether the current focus on self-regulation can be effectively substantiated.

The last of the prominent analytical approaches to nonprofit oversight and regulation is the new state activism discussed in this Review, typified — at least in New York — by the aggressive intervention of the New York Attorney General in the Wallace-Reader’s Digest and New York Community Trust matters. Activist state authorities have advantages in the oversight and regulation of the nonprofit sector, an arena traditionally regulated at the state level, as the Silber volume discusses, and still governed in great measure by state law. The closeness of state authorities to local nonprofit activities, and the powers already available in state law, would seem to make state officials a natural source of increased nonprofit oversight.

But a renewed state activism in nonprofit oversight, whether exercised formally or informally, has real potential disadvantages as well. When state authority is used informally — as in Wallace-Reader’s Digest — it can have beneficial consequences in individual cases, but remains unevaluated by judges and holds the potential for overreaching. And judges have rebelled against certain aspects of the new state activism, as in the New York courts’ refusal to require notice by community foundations to the Attorney General upon exercise of the variance power. Moreover, activism in one or several states threatens to magnify the already highly inconsistent nature of state oversight, as many state attorneys general or secretaries of state have neither the interest nor the resources for a more active approach. Perhaps most important, a new state activism in oversight of the nonprofit sector

71. This typology relies on the excellent work of Robert Bothwell. See Bothwell, *supra* note 70. Other very useful recent work in this area includes Joel Fleishman, *Public Trust in Not-for-Profit Organizations and the Need for Regulatory Reform*, in PHILANTHROPY AND THE NONPROFIT SECTOR IN A CHANGING AMERICA (Charles T. Clotfelter & Thomas Ehrlich eds., 1999), and Peter Swords, *Nonprofit Accountability: The Sector’s Response to Government Regulation*, Norman A. Sugarman Memorial Lecture, Mandel Ctr. for Nonprofit Organizations, Case Western Reserve University, Mar. 16, 1999, available at www.qual990.org/np_account.html.

holds distinct potential for direct politicization of the Attorney General's role, the likelihood if not the certainty of heightened state scrutiny of specific nonprofits — or nonprofits representing specific groups — when politics, as well as oversight and legal principles, may demand it.

Despite these real problems, a new state activism in oversight of the nonprofit sector appears likely to remain a force in coming years. In fact, it may be that both of these latter approaches — a new state activism in nonprofit oversight and increased attention to self-regulatory structures — will have continuing impact on the nonprofit sector. Each affects primarily the post-chartering world of nonprofit operations, not primarily the establishment or chartering stage itself. In that sense, these new, or renewed, approaches stem from a historical process in which state-level oversight of nonprofits has shifted from a strong state discretionary role in chartering to a more limited chartering role, with decades of exploration of alternative paths to oversight and regulation of nonprofits and charities already in operation. If strong discretionary state chartering is no longer acceptable as a normative proposition, then post-chartering oversight and regulation through some means, or some combination of means, must become more effective. The new state activism, though fraught with problems, shows one of the possible ways forward.