Attorney General Oversight of Charities

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INTRODUCTION: HISTORICAL ROOTS; BASIC POWERS

The power of the attorney general to regulate charities has its roots in earliest English law. Its origins are to be found in the law of trusts. A trust is valid only if there are beneficiaries existing and able to ensure that the trustees fulfill their duties. An essential element of a charitable trust was, and is today, that its purposes must provide broad public benefit; as a corollary, there can be no specific identifiable beneficiaries who can monitor the trustees’ actions and seek to correct abuses of trust. The dilemma was resolved by the common law courts by assigning to the attorney general, acting for the king in his role as parens patriae of the country, the duty to represent the public – as the ultimate beneficiary of all charitable trusts – in assuring that charitable trustees were fulfilling their duties. These included the duty of loyalty under which a trustee is required to act solely in the interest of the beneficiaries, refraining from any self-dealing and assuring that the purposes of the trust are carried out, and the duty of care under which a trustee is required to act prudently and not endanger the trust assets through reckless or negligent acts.

Early cases involving charities are to be found in Carl Zollmann’s landmark study, American Law of Charities, in which he affirms the oversight role of the attorney general in regard to charities.

It is ... not only the right, but the duty of the state, through its law officers, to take action for their maintenance and enforcement. This duty is exercised in America as in England through the attorney general, who, therefore, is a proper, though he may not be a necessary party plaintiff or defendant as the representative of the public, and whose duty is to prevent the breach and to enforce the proper

application of a charitable trust, and to compel the restitution of any part thereof which has been diverted to other purposes.\(^2\)

The attorney general’s power is not all encompassing. Rather, it is the courts that are empowered to correct abuses, while it is the attorney general’s duty to bring abuses to the attention of the court and seek correction. The courts are granted wide power to correct abuses, including removing trustees and appointing successors, ordering restitution, imposing fines, issuing injunctions to prevent continued abuses, and appointing receivers. This is not to say that an attorney general is powerless to correct abuses. In fact, the threat of suit is often as powerful a weapon as actually initiating suit, and parties are entitled to settle issues with the attorney general in order to avoid further legal action.

A concomitant of the power of the attorney general to bring suit to correct abuses by charitable fiduciaries has been a limit on the power of others to bring fiduciaries to account. With only a few exceptions, members of the general public are not permitted to sue charitable fiduciaries for breach of duties; rather this is the exclusive power of the attorney general. The rationales for this doctrine of limited standing have been that individuals will not serve as trustees if they may be subject to suits by disaffected members of the public and concern that private individuals will may use this power to advance their own ideological policy preferences. Furthermore, individuals may not bring suit to force an attorney general to sue a charity or its fiduciaries for breach of duty.

This description of early common law is also the description of current law governing the oversight powers of the attorney general in Great Britain and in every one of the United States. In a number of states these powers have been enlarged by statute as

an aid to enforcement. Thus, the attorney general must be given notice of legal proceedings brought by or on behalf of a charity if the suit involves breaches of fiduciary duties or the validity of a gift for charitable purposes, a request to change charitable purposes specified by donors or alter methods of administration, or the disposition of a substantial portion of a charity’s assets. In some states, notice of a petition to probate a will with charitable gifts must also be given to his office and, as more fully described below, in some states certain charities must register and file financial reports with his office.

MID-TWENTIETH CENTURY EFFORTS TO ENHANCE OVERSIGHT

Given the extensive power of an attorney general, one might assume that oversight has been commonplace. In fact, just the opposite has been true. Until mid 20th century, it was the rare attorney general who was willing to commit what were always limited funds and personnel to this aspect of his duties. In 1943 the attorney general of New Hampshire persuaded the legislature to adopt an act affirming his common law oversight powers and requiring charitable trusts in the state to register and file financial reports with his office. The rationale was that an attorney general could not carry out his duties as supervisor of charitable funds without knowledge of the charities within his jurisdiction and the nature and extent of their programmatic and financial dealings. In the early 1950s statutes patterned on the New Hampshire one were enacted in Rhode Island, South Carolina, Massachusetts and Ohio.

In 1954, through the efforts of the New Hampshire attorney general who had framed the statute in his state, the Commissioners on Uniform State Laws adopted a
Uniform Supervision of Trustees for Charitable Purposes Act that was subsequently adopted in California, Illinois and Michigan, while New York in 1967 adopted one similar to the Massachusetts act. By 1968 there were ten states with registration and reporting requirements and in those states the attorney general also had been conferred powers to investigate potential abuses, thereby enhancing his ability to obtain information adequate to permit him to determine whether to bring suit.

Today there are 12 states in which certain charities are required to register and file annual reports with the attorney general: California, Illinois, Massachusetts, Michigan, Minnesota, New Hampshire, New Mexico, New York, Ohio, Oregon, Rhode Island, and South Carolina. However, in Minnesota, Rhode Island and South Carolina, the filing requirements apply only to certain charitable trusts, while the majority of charities in these states are exempt. In contrast, in Massachusetts the registration and filing requirements apply to all charities other than those with religious purposes. California exempts educational institutions, hospitals and health care service plans. The exemptions from the New York reporting requirement are typical of the remaining states; in addition to those exempt under the California law, they include fraternal and veterans organizations, student alumni associations, historical societies chartered by the state Board of Regents, certain trusts with out of state corporate trustees, organizations that support those charities that are themselves exempt, governmental entities and government-controlled trusts and certain parent-teacher organizations.

In all of these states, the annual reporting requirement may be met by submitting Form 990, the Federal information return required by the IRS from exempt charities with annual gross receipts in excess of $25,000. A number of these states require some
additional financial information and three require charities with gross receipts over a
certain amount to have their financial accounts audited. In Massachusetts this
requirement applies to charities with gross receipts of $500,000 or more, in New
Hampshire the threshold is $1 million, while in California, it is $2,000,000.

OVERSIGHT OF CHARITABLE FUNDRAISING

The state registration and reporting requirements are designed to provide an
attorney general with information about the entire operations of the reporting charities
and are designed to enhance his ability to correct failures of trustees to carry out their
fiduciary duties. Fundraising by charities is also subject to state regulation in 39 states,
including 11 of the 12 with general reporting requirements. State regulation of
solicitation originated as part of the consumer protection movement in the mid 1960s. As
such, it applies not only to fundraising by charities, but to for-profit entities that solicit
for charities or in the names of charities. In 14 of these states, the situs for registration
and reporting is the office of the attorney general. In Massachusetts, New York, Illinois,
Ohio, New Hampshire, New Mexico, and Minnesota, both regulatory programs are
administered in the same division. In 16 states, the attorney general shares jurisdiction
with another state agency, while in four other states, the secretary of state administers the
provisions of the solicitation statute. In Florida, the regulatory body is the Department of
Agriculture and Consumer Services; in Connecticut it is the Department of Consumer
Protection; and in Mississippi, Oklahoma, and Kansas, the district attorneys have
jurisdiction. In Pennsylvania, the attorney general, secretary of state, and the district
attorneys share responsibility, although enforcement originates in the office of the
secretary of state, which refers matters to the other governmental agencies for prosecution. In California, there is no separate state-wide regulation of charitable fundraising, although in 2004, as part of a revision of its charity laws, professional fund raisers were henceforth required to register and report, charities were prohibited from entering into contracts with commercial fund-raisers who had not registered with the attorney general, and were required to adopt certain safeguards in their contracts with the professionals.

Solicitation statutes provide safeguards for those who handle funds, including the posting of bonds. Some states require charities to provide written notice to persons being solicited of the fact that information about the charity may be obtained from either the state or the charity itself. There is little uniformity in these requirements so that charities soliciting nationally may be required to include three or more different notices in their solicitation materials.

These solicitation statutes also include definitions of prohibited deceptive acts or practices and contain criminal and civil sanctions for violations. Many specify dollar penalties and prison terms for serious violations. The agency assigned the duty of enforcement is given broad powers to conduct investigations, subpoena witnesses and demand documents. The broad equity powers of the courts over charitable fiduciaries extend to violations of the solicitation laws.

Audits of financial accounts of charities subject to these statutes are required in 15 of the states that regulate charitable fundraising if receipts exceed a specified threshold. Some contain a dollar threshold for registration so long as the charities do not use paid
solicitors. Contracts with solicitors, fundraising counsel and commercial co-venturers must also be filed with the state.

The major drawbacks to these solicitation statues are the extensive exemptions to their reporting provisions and the difficulties of policing solicitations originating from outside the state. For charities attempting to be in compliance, the burden is onerous, due to the fact that there is no uniformity in coverage, the thresholds for initial filings vary widely, and the application of the statutes to foreign charities is not clear.

Thirty-four of the solicitation statutes do follow a Model Act adopted in 1986 by the National Association of Attorneys General (NAAG) and the National Association of State Charity Officials (NASCO). In 1998 NASCO developed a uniform initial registration statement that has been adopted in 33 states, although seven of them require supplemental information. However, there is no common form for annual reports, although most require that a copy of the Federal Form 990 accompany the state form.

In 1999 the state regulators at a NASCO meeting attempted to deal with the rapid proliferation of internet solicitations. They adopted a set of principles, named the Charleston Principles after the place where they met, defining the circumstances under which a charity soliciting funds on the Internet would be required to register and report in a specific state. The threshold for jurisdiction is maintenance of an interactive web site that specifically targets individuals in a particular state or receipt of substantial contributions from persons in that state on a repeated and ongoing basis as a result of the Internet solicitations. Ability to enforce such provisions is, inevitably, difficult if not impossible.
CONSTITUTIONAL CONSTRAINTS ON REGULATION OF SOLICITATION

During the 1960s and 1970s there were fairly wide spread press coverage of charities soliciting funds from the general public who were spending all or nearly all of the amounts they were raising on their fund raising efforts so that little if any amounts were being expended for charitable purposes. The response in a number of states and local municipalities was to place statutory limits on the amount that a charity could spend on fundraising. However, in 1980 the U.S. Supreme Court held such limits to be unconstitutional violations of the free speech provisions in the First Amendment. In *Schaumberg v. Citizens for a Better Environment*[^3], the court struck down a town ordinance that placed limits on the amounts a charity could spend on fundraising. Four years later the court in *Secretary of Maryland v. Munson*[^4] also held unconstitutional a state law limiting the cost of fundraising similar to those in *Schaumberg* but permitting the state to waive the limit under certain circumstances. In a third case, *Riley v. National Federation of the Blind of North Carolina, Inc.*[^5], decided in 1988, the Court struck down provisions in a North Carolina law that required professional fundraisers to obtain a license before soliciting, adopted a presumption that fees exceeding 35% of gross funds raised was unreasonable, and required solicitors to disclose at the point of solicitation the amount of their fundraising costs.

The most recent case dealing with charitable solicitations involved prosecution by the Illinois attorney general of a charity that was found to have misrepresented the amount it was spending directly on its charitable activities. In what state regulators considered a major victory, the Supreme Court in 2003 in the case of *Illinois, ex rel.*

Madigan v. Telemarketing Associates, Inc. held that the First Amendment did not prohibit an attorney general from bringing suit against professional fundraisers for fraud when the fundraiser falsely represented to donors that a substantial portion of the amounts donated would be used for specific charitable purposes. The state attorneys generals viewed the case as important support for their efforts to regulate solicitations, efforts that they believed had been severely hampered by the prior decisions, although it was in fact a reaffirmation of language in the Riley decision urging the states to enforce their anti-fraud statutes.

CHARITIES OPERATING ACROSS STATE BORDERS AND IN MULTIPLE STATES

Both the registration and reporting statutes and the solicitation laws apply not just to organizations formed within a particular state; under certain circumstances they also cover charities incorporated or created in other jurisdictions. As noted in regard to internet solicitations, the extent of jurisdiction of these state laws is not always clear. Generally, a state may regulate an organization that “does business” or “holds property” within its borders, with the definitions of these terms following those used to determine state court jurisdiction over nonresident defendants. In order for a state to assert jurisdiction, there must be some systematic, ongoing activity within the state. Under trust law, the defining criterion is the state having the most significant connections to the trust. This includes the domicile of the trustees, the physical location of its assets and the place where its business is carried out. Similar factors are considered in the case of corporations. State laws requiring foreign business corporations to register with the

secretary of state or corporation commissioner will usually also apply to charities meeting the criteria. Uniformly, they will require appointment of a resident agent upon whom service of process may be rendered. The problem for charities is to determine how much activity or property will give rise to a need to register and report and this is more often than not unclear.

The “Internal Affairs Doctrine” is a conflict of laws doctrine that is applicable to corporations. It provides that the law of the state of incorporation is to be looked to in regard to the internal affairs of a corporation, rather than the state in which it operates. The principle has been generally adopted, although there are some states, including California and New York, that have attempted to apply their domestic corporate law to foreign business corporations that meet certain thresholds regarding their activities in those states.

In a 1978 California case, the state appeals court applied California law to a dispute over the power of a foreign charitable corporation to remove a director, rather than the law of the state of incorporation. Recognizing that California generally followed the internal affairs doctrine, the court nonetheless refused to do so in this instance in view of the fact that the charity had been organized by California residents, was located in the state, and had all of its assets and most of its activities there. “… [W]e believe that actions taken in California concerning the administration of that charity should not escape the scrutiny of California law, merely because the founders chose to incorporate elsewhere.”

The case may be of limited precedent, however, due to the fact that, as the court noted,

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the differences between the laws of the state of incorporation and of California were not so significant as to have required a different result if California law had not been applied.

For charities with substantial activities in states other than the state of incorporation, examples of the questions that can arise are whether an audit requirement, or rules governing the composition of boards or imposing restrictions on their soliciting practices are to be determined by the laws of the state of incorporation or the state or states in which the charity operates. Obviously, if several states in which a charity operates claim jurisdiction over its internal affairs, compliance could become near impossible.

Determining the extent of state jurisdiction over foreign charities is not a new problem. However, it received renewed attention in 2004 after California passed legislation requiring certain charities registered with the attorney general to have an audit committee, to adopt certain procedures to be followed in determining officers' compensation, and in contracting with certain types of professional fundraisers. A posting on the web site of the attorney general implied that the requirements would apply to charities operating in or holding property in the state and questions were raised as to the extent to which these requirements, as well as certain limits under prior law on board composition, would apply to charities owning investment property in the state or sending mail solicitations to residents. At a meeting of the ABA Tax Section Exempt Organization Committee in 2005, the Assistant Attorney General In charge of the

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Charities Division indicated that they did not intend to change existing law governing internal affairs. However, the information on the Internet remains unchanged.  

ATTORNEY GENERAL OVERSIGHT IN PRACTICE

The work of a charity division in the office of an attorney general is varied. Much of the time of the attorneys is devoted to litigation, participating in suits brought by other parties where the attorney general is a necessary party or, more rarely, prosecuting charities or their fiduciaries on their own motion. Potential breaches of fiduciary duty may be uncovered by staff accountants in the course of reviewing annual reports. More often matters are brought to the staff’s attention by disaffected parties.

The issue then will be the reliability of the complainant and the validity of the complaint. The nature of the complaints cover a wide range, from allegations of failure to carry out the charity's purposes, improper self-dealing, disregard of restrictions on expenditure of gifts or endowment, imprudent investments, misleading fundraising, excessive expenditures on compensation or fundraising. For charities in financial trouble, the attorney general's office will have to determine whether receivership is appropriate. In some instances an attorney general will be called on to intervene in a bankruptcy proceeding to protect endowment funds which are not part of a bankruptcy estate.

In conducting investigations, in those states with active enforcement programs, staff will have access to financial reports already on file and will also be empowered to conduct formal hearings and demand documents. In the remaining state, the information will have to be obtained by other means, including inquiries to the IRS and the charity

itself. If the attorney general determines that litigation is warranted, the major consideration in moving forward, of course, will be availability of staff and funding. There will be standing issues to resolve, in particular whether private parties should be permitted to intervene, or whether relators could be appointed to act for the attorney general. There will also be the question of what sanctions should be sought - removal, restitution, surcharges - and the effect of immunity provisions, liability shields and the availability and impact on the litigation of the existence of directors and officers insurance. Use of the threat of litigation to force settlements - which has led to charges of overreaching by an attorney general - is discussed below.

Often, particularly if mismanagement or board malfunction is involved, the staff will be able to work with the charity's fiduciaries to improve the situation and confidentiality can be preserved. When the matter involves application of the cy pres doctrine, the questions are of a different nature and the attorney general may be called upon to decide between conflicting claimants for the funds and forced to determine where the greatest benefit to the affected community lies, a decision that will not always been acceptable to all interested parties.

A new challenge to the role of the attorneys general in preserving charitable funds arose in the late 1990s and early 2000s when there was a surge in the number of charities, notably health care organizations and nonprofit insurers, that attempted to convert from nonprofit to for-profit status. In several of the early conversions, the proceeds ended up in the hands of the fiduciaries of the converting entities or were added to other state funds, rather than being held under cy pres principles for continued charitable purposes. During a period of four years, twenty-five states enacted statutes explicitly granting the attorney
general the power to regulate conversions of health care organizations. Another ten states enacted statutes requiring approval by the court or the attorney general before the conversion, while in three others, conversions were prohibited. These developments posed problems for attorneys general who had not previously been active in charity regulation, while for others it was a reaffirmation of the positive role that can be played by that office. The speed with which these statutes were enacted indicated that, given sufficient financial interest, state legislatures were willing to increase regulation, in direct contrast to the lack of interest in improving or expanding more regulation of charities that has been the case for nearly 50 years.

There is a good deal of cooperation among state officials in connection with interstate solicitations, less so in regard to abuse of fiduciary duty. As more fully described below, in recent years there have been several major cases in which two or more attorneys general disputed the disposition of the assets of charities operating in their respective jurisdictions, but these instances have not been commonplace.

Charity offices in a number of states attempt to provide affirmative support to the sector by publishing and disseminating information regarding fiduciary duties in print, over the internet and by sponsoring conferences for trustees, directors, lawyers and accountants. Their personnel are available for consultation with fiduciaries on questions relating to application of the cy pres doctrine and on framing petitions for dissolutions. In fact practitioners representing charities seeking application of the cy pres or deviation doctrines have found it prudent to seek advance agreement from the attorney general of the plan for which they are seeking court approval before it is filed in court, as it is the rare court that will approve any application as to which the attorney general has
expressed reservations or objections. Participation in these matters can be one of the most rewarding aspects of the oversight function, assuring as it is designed to do the future utility of funds that are intended to continue in perpetuity.

Following a precedent begun in 1961 in Massachusetts, a number of attorneys general have established advisory committees comprised of representatives from the charitable sector and affected communities that meet on a regular basis to address common problems, assist in developing reporting forms, and framing and supporting legislation designed to improve the operations of the office. In contrast, from time to time there have been attorneys general who have interpreted their oversight function to be limited to prosecution of wrongdoers. In their view activities designed to support the sector and improve understanding of fiduciaries’ duties are inimicable to that primary function and impede their effectiveness. This does not appear to be a widely held view currently.

Valuable insight into the workings of the charities divisions of the state attorneys general was provided in a 2006 study conducted by the Council on Foundations and the Forum of Regional Associations of Grantmakers, in collaboration with NAAG-NASCO. Entitled “The Value of Relationships Between State Charity Regulators and Philanthropy”, its authors David Biemesderfer and Andras Kosaras conducted a survey of the regulation of charities by the attorneys general in 16 states. Included were the eleven states with general registration and reporting statutes (not restricted to charitable solicitation), and four additional ones, Florida, New Jersey, Pennsylvania and Texas.

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thereby including in the survey those states with the largest number of private foundations.

Among the findings from the survey was that attorney general oversight most often fell within the purview of the consumer protection division or an equivalent division. Unlike the situation in the majority of states, where attorneys and staff are assigned to charities work only as necessary and not to separate charities sections, in almost all of the 16 states in the survey, there was a separate charities unit, often within the consumer protection division. The authors found it difficult to determine accurately the exact number of staff assigned to charity oversight and compare staffing levels. They reported that the states with the largest number of full time attorneys were New York, with 20, Pennsylvania with 12, California 11 and Ohio 10. Illinois had seven attorneys and Massachusetts and Texas each had six. At the other extreme, Oregon had three attorneys and New Hampshire one. At least six of the 16 states employed auditors or financial investigators, while additional staff handled the registration function. The authors compared these findings with surveys conducted the 1970s and 1990s and concluded that there has been no significant increase in the number of attorneys assigned to charity oversight.

As to the funding of enforcement activities, in the 11 states with general registration and reporting statutes, filing fees required in four of them are deposited in the general treasury. In the five states that have adopted the Uniform Act, fees are earmarked for enforcement. In some of these states, attorneys’ fees, fines and penalties collected from enforcement actions are also earmarked for charity regulation. The size of the fees varied among the states. Registration fees ranged from $15 to $50, with five states
imposing no fee. The fees for filing annual reports similarly varied, and in most instances were based on a sliding scale.

In recent years, the charities divisions in the surveyed states have increased outreach efforts, particularly through the internet. In eight of the 16 states, there was a hyperlink on the attorney general’s website home page to the charities section, while five states had links to the consumer protection division. Almost all of the states reviewed publish guides describing the laws regulating charities and the role of the attorney general. The 57 page California Attorney General’s Guide for Charities is the most comprehensive. NASCO also has links on its website to the charities divisions in its member states. This survey also included case studies of efforts to improve relationships between the attorneys general and the charitable sector in four states, Illinois, Michigan, New Hampshire and Ohio through the establishment of advisory committees.

One of the greatest drawbacks to assessing the efficacy of attorney general oversight is the lack of knowledge of both the extent of abuse and the degree to which states efforts have been successful in correcting them. This also means that it is not possible to determine with any certainty whether regulation is too stringent or too lenient. In an attempt to better understand the extent of wrongdoing by charitable fiduciaries, my colleague Andras Kosaras and I undertook a computer search of press reports of stories describing breaches of duty by directors, officers and trustees of charities published between 1995 and 2002 and included in the 13,111 sources in the data base of Lexis/Nexis. We identified 152 incidents involving civil or criminal wrongdoing, with 6 in both categories, with 104 criminal cases and 54 involving breaches of the duties of loyalty and care. Among the factors we attempted to identify were the investigating
agency and the source of information on which it was instigated. The investigating agencies in the criminal cases were, primarily, district attorneys and U.S. attorneys, with attorneys general playing a minor role. In contrast, in the 54 breach of fiduciary duty cases, the attorney general brought suit or investigated 37 of them, while there was one case involving a U.S. attorney and one a district attorney. Of the cases investigated by an attorney general, 21 of them resulted in the filing of a civil law suit. The largest number of cases brought by an attorney general, nine, were brought in New York, while four were brought in Minnesota, three in Texas and two each in Illinois, Massachusetts, Oregon and Tennessee. We also attempted to ascertain how the prohibited activity came to light. Seven instances were uncovered during an audit by a governmental agency that had been a grantor to the charity. In 18 instances, wrongdoing was first identified during routine internal audits, 18 were brought to light by whistleblowers, and 11 were brought to light in press reports. None were specifically attributable to an independent investigation by an attorney general.

With 152 incidents of wrongdoing during a seven-year period from a universe of an estimated 1.4 million charities, we concluded that there may be serious under-reporting and an untold number of incidents that do not come to light due to federal and state laws respecting privacy. As to the question of whether stricter rules are needed or enhanced enforcement of existing laws would be sufficient to deter wrongdoing, we concluded that the study results did not provide an adequate basis on which to make an informed judgment. We did note, however, that the outcomes of the fiduciary duty cases demonstrated the important role state regulators can play in protecting charitable funds,
whether by terminating or reorganizing charities or removing and replacing fiduciaries who have breached their duties.\textsuperscript{11}

SHORTCOMINGS OF ATTORNEY GENERAL OVERSIGHT

The major criticism of attorney general oversight of charities until recent years has been lack of attention. Recently, however, complaints have centered on the opposite, namely overreaching and interference with the legitimate operations and structure of charities within their jurisdiction.\textsuperscript{12} In addition, as noted above, there have been a number of well publicized incidents in which attorneys general from two or more states have found themselves in dispute over the proper disposition of assets held in their jurisdictions by organizations that operated in many states. Examples of this latter situation arose in 2003 and 2004 in cases in which national health care agencies were seeking conversions or sale of their properties. Of note were the disputes over disposition of the assets from the conversion of Health Midwest that operated in Missouri and Kansas. The attorneys general from both states sued to remove Health Midwest's board for abandoning their charitable purpose. The matter was resolved with agreement to a settlement under which the sale was permitted to proceed and the proceeds were divided into two separate conversion foundations, each to operate with oversight from the attorneys general in their respective jurisdictions.

Another example involved the attempt by Banner Health System, an Arizona nonprofit charity, to sell its facilities in North and South Dakota and concentrate its


operations in Arizona and Colorado. The North Dakota dispute was settled with a payment by Banner of $1 million to be used to fund charitable activities in the state under the supervision of the attorney general. The South Dakota case was similarly settled, in this instance with payment in 2004 of $1.8 million to five South Dakota communities as compensation for the sale of three hospitals and five nursing homes in those areas.13

In an unusual case originally filed in 2004 and settled in 2007, the attorneys general and the courts in Mississippi and Tennessee were called on to determine the propriety of one of two trustees of a charitable trust moving its assets from Tennessee, the state in which it was created, to a Mississippi charitable corporation she established and of which, under Mississippi law, she could be the sole director. The legal suits brought in both states included allegations of misuse of the charitable funds in both states. However, under a settlement approved by the Mississippi court, $55 million was to be distributed to a newly reconstituted Tennessee trust, the trustees of which will be appointed by state officials with state court approval, while approximately $50 million will be retained by the Mississippi charity. The allegations of misuse of funds were not discussed in the settlement and to date there is no public evidence that they will be pursued.14

Given the fact that the office of attorney general is an elective position in all but seven states, it is inevitable that politics will enter into decisions as to how to handle charity cases. This is particularly true where the issue is whether assets can be moved from the state to another jurisdiction. Some would argue that it is unrealistic to expect a state official to take a position other than a parochial one. Of the seven other states, the

attorney general is appointed by the state supreme court in one, by the legislature in one other, and by the governor in the remaining five. These differences do not appear to have had an appreciable effect on the nature of charity regulation, but warrant further examination.

Charges of politicization of charity cases have also been brought from time to time against attorneys general in cases that have arising when that official was running for another political office, such as governor. This was the situation in the well publicized efforts by the then attorney general of Pennsylvania to block a sale by the trustees of the Hershey Trust of the controlling interest the trust held in stock of the Hershey company. Among the outcomes were a substantial change in the Pennsylvania Modern Prudent Investor Rule, a substantial loss in the value of the trust assets by virtue of the prohibition on their sale, and the forced resignation of the Board that had considered the sale and their replacement by the court and the attorney general.\textsuperscript{15} In another instance in which geography was a major factory, the attorney general of Illinois successfully blocked a plan adopted by trustees of the Terra Foundation for the Arts in Chicago to move the Museum out of the state.\textsuperscript{16}

Another recent example, one that represented an extreme act of overreaching, was the attempt by the Michigan attorney general in 2006 to force the Ford Foundation to increase its grant making in the state. He attempted to accomplish this by proposing legislation that would have amended the "Michigan Uniform Supervision of Trustees for Charitable Purposes Act" by specifically empowering the attorney general to enforce


\footnotesize{\textsuperscript{16} Brody, \textit{supra} note 12.}
through court proceedings the intent of grantors' concerning grants and distributions from charitable trusts (under Michigan law this includes charitable corporations) and adopting a presumption that, unless a contrary intent was specifically established in the governing instrument, grants made in the first five years of the trust would determine where the donor intended them to be made and the nature of the recipients. In addition, it would be presumed that the intent of the grantors would be violated if less than 50% of the amount of the trusts’ grants or distributions in the most recent 3-year period before the action was commenced were made to recipients outside of the geographic location where the grantors established the trust or if they were made to different types of recipients to which grants or distributions were made in the period from the appointment of the original trustees to the date on which a majority of the trustees were not the original trustees. The effective date was not specified but the attorney general made it clear that the provisions were to apply to all trusts and charitable corporations whenever created, not just those established after the effective date. Strong opposition to the bill was expressed both within and outside of the state and as of October 2007, the legislature had not acted on it.17

Another set of recent instances in which charges of politicization have been raised involved attempts to convert Blue Cross/Blue Shield and similar third party payer health insurance plans to for-profit status. Brody's study recounts the dispute involving Maryland, Delaware and the District of Columbia in which the Maryland legislature effectively prohibited the conversion of CareFirst, a plan that operated in all three states,

regardless of the fact that the regulators and plan subscribers in D.C. and Delaware were not opposed to the proposed action. 18

The controversy over a proposal to convert Empire BlueCross BlueShield of New York exemplifies the problems that can arise when an attorney general, for political reasons, declines to represent the public interest in a dispute over charitable funds. Under New York law, conversions of nonprofit health insurance organizations were prohibited unless the legislature specifically approved the transaction. Starting in 1996, Empire attempted to convert relying on proposed legislations under the terms of which the proceeds of the conversion would be held by a charitable foundation. While the bill was pending, at the behest of Governor Pataki, it was amended so that only 5% of the proceeds would be set aside for the foundation, while 95% would be added to the state budget to be used to raise the salaries of healthcare workers. Attorney General Spitzer and his predecessor had acquiesced in the original plan for disposition of the conversion assets. However, when the legislature subsequently altered the plan, he took the position that it was his duty to uphold the statute. Not only did he not protest the diversion of funds, but in a suit to block the transaction brought by consumer groups, he asserted that they had no standing to pursue their claims. The court ultimately granted standing to the plaintiffs on the basis that they had a "special interest", noting that it was the duty of the attorney general to defend the statute, but that his failure to do so left the beneficiaries without representation and expanding standing was a reasonable solution to the

18 Brody, supra note 12 at pp. 1019-1026.
problem. Ultimately, the suit failed and the conversion was accomplished, with approximately $6 billion transferred to the state.

The Empire case illustrates the need for an exception to the standing rules when the attorney general has conflicting duties and either cannot, or chooses because of the conflict not to bring suit. In such situations, he is empowered under common law and in some states by statute to appoint relators to bring suit on his behalf, or he can appoint private individuals to serve as special assistant attorneys general to represent the charitable beneficiaries. California has codified this procedure by statute. However, use of relators is not a common procedure. In no event should an attorney general be permitted to prevent the charitable interests from being heard in court.

Another shortcoming of state oversight arises from misunderstanding on the part of state regulators of the federal tax rules that govern the formation and operation of charities. This was highlighted in a unanimous decision of the Massachusetts Supreme Judicial Court in October 2006. The case was brought by the trustee of a perpetual trust established in 1959 to apply the net income to provide scholarships to graduates of the high school in the city in which the donor had resided. The trustee’s petition, to which the attorney general assented, requested the court to modify the terms of the trust in three respects, one of which to was to permit it to increase the aggregate annual trust distributions so that they would equal the amount required to be distributed annually by private foundations under Internal Revenue Code section 4942, currently equal to five percent of the value of the foundation's investment assets. The trustee had alleged that the

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change was necessary if the trust was to avoid the tax on private foundations imposed under section 4942 as well as under Massachusetts General Laws section 68A that applies the federal rules to Massachusetts private foundations.22

The court rejected the trustee’s request, holding that such a change, although it would "avoid a relatively small tax," would result in annual distributions of a large portion of the principal, thereby departing from the donor's intent that the trust be perpetual.23 This conclusion ignored, as did the briefs submitted by attorneys for the trustee, the fact that section 4942 provides for two levels of tax: an initial tax equal at the date the decision was rendered to 30% of any undistributed amounts remaining at the end of each tax year; and an additional tax equal to 100% of the amount remaining undistributed at the end of such year and each succeeding one. Thus the court's conclusion that without reformation it would be possible to use some of the income for scholarships and the rest for tax without touching the principal misstated the effect of its decision, reflecting a profound misunderstanding of both the Internal Revenue Code provisions and Massachusetts laws governing charities on the part of all parties, including the attorney general.

Seven months after the U.S. Trust Company decision, the Massachusetts court in effect overruled the case, noting that the impact of the second level tax had not been brought to its attention during oral argument. "It is now apparent that our reasoning on the matter...rested on incomplete information and, therefore, is incorrect and creates a

22 At the date the petition was filed, the tax was equal to fifteen per cent of the difference between the required distribution and the amount actually distributed at the end of each tax year in which it remains undistributed. This was increased in 2006 to 30% effective for tax years beginning after August 17, 2006.
precedent that should not be followed in like situations.” The court suggested that the trustee of the scholarship trust might in the future wish to seek further reformation and indicated its willingness to reconsider its decision “in order to achieve consistency in our treatment of similarly situated parties who appear before us.”

In addition to criticisms of attorney general oversight on the grounds that it is ineffective and too often fueled by political considerations, there are two trends in enforcement that have raised concerns among commentators as to whether the attorney general is the most appropriate regulator. The first concern relates to the increasing use by attorneys general of the threat of litigation to force charities to agree to settlement of disputes with conditions that are far more restrictive than the law requires or that might be imposed by a court.

One example is a settlement between the Massachusetts attorney general and the trustees of Boston University of a controversy over the university’s investment policy. Under the terms of the settlement, the trustees agreed to changes in governance, including mandating fixed terms of office for directors, giving alumni and faculty a voice in nominating board member and requiring that certain procedures be followed for approving the salary of the president.

The Massachusetts attorney general imposed similar terms in a 2006 settlement reached after he threatened litigation that would have delayed sale of the Boston Red Sox by the successors to the original owners, one of which was a charitable foundation. Among the terms of the settlement, the trustees of the foundation agreed to changes in

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24 In Re Will of Crabtree, 865 N.E.2d 1119 (Mass. 2007).
their governance that included appointment of five new trustees acceptable to the attorney general and adoption of a conflict of interest policy approved by him.\textsuperscript{25}

As noted above, in the resolution of the controversies involving the Hershey Trust and the Terra Foundation the attorneys general in Pennsylvania and Illinois respectively exercised strong influence over the composition of the boards. Brody also describes in her 2004 article efforts of the attorney general in Minnesota to name members of the boards of three health care plans, Alina Health Care, Health Partners and Medica Health Plan.\textsuperscript{26}

Although the state officials involved in each of these examples are unlikely to agree, they represent unwarranted extension of oversight powers into areas in which the law has traditionally granted autonomy to fiduciaries. In other words, an attorney general is not empowered to regulate or direct the day to day affairs of a charity and certainly not to second guess the decisions of its fiduciaries as to how they will carry out their mission. It is difficult to imagine remedies to prevent this type of overstepping; better public understanding of the limits of state power might be a first step.

**MEASURES TO IMPROVE STATE OVERSIGHT**

*INCREASE FUNDING:* The short comings of attorney general oversight have long been attributed to the lack of funding of state programs, which has meant lack of adequate staff and, consequently, ineffective policing. As noted, in a few states, filing fees are earmarked for support of the regulatory programs while in others, the fees are


\textsuperscript{26} Brody, *supra* note 12 at pp. 1004-1008.
added to the general state treasury. In none of them is the amount raised sufficient to support meaningful oversight. In all states, charity regulation competes with other duties of the attorney general, often having the lowest priority.

In the 1960s I suggested federal funding of state programs similar to the funding of unemployment insurance and social security programs, whereby federal funds would be available to states that adopt certain standards for charity administration and establish a regulatory program that meets federal requirements. The suggestion was uniformly ignored until 2004 when increased funding to the states for charity regulation was one of the recommendations from the 2004 Senate Finance Committee Staff for reforming oversight of charities. The Panel on the Nonprofit Sector in its Final Report supported increasing federal funding to the states to establish or improve regulation conditioned on their adopting uniform state filing requirements and minimum standards for oversight and enforcement. I remain pessimistic as to the prospects of improving state oversight without such financial support, but equally pessimistic as to the possibilities of Congress providing it.

**PROVIDE INFORMATION AND SUPPORT TO ATTORNEYS GENERAL:** There is a new initiative from NAAG that may signal a change in attitude among the attorneys general. It is one that, if successful, could result in improved, and possibly more widespread activity. In the spring of 2007, NAAG and Columbia Law School, received funding for a program designed to generate broader interest among the attorneys general in expanding and improving existing regulation of charities. Among the activities

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contemplated are establishment of a clearing house for information on state and federal enforcement efforts, available to regulators through a web site; providing technical assistance to individual attorneys general and their staff interested in instituting or expanding regulatory efforts; and publishing independent materials on the intersection of charities and state regulation. An advisory committee comprised of regulators, academics and practitioners has been established to guide the managers of the project. They held a first meeting in early October 2007.

EXPAND STANDING RULES TO ASSURE REPRESENTATION OF THE PUBLIC IN MATTERS AS TO WHICH THE ATTORNEY GENERAL IS A NECESSARY PARTY BUT CANNOT OR WILL NOT ACT: In the last ten years, many scholars and practitioners, frustrated with the lack of effective state regulation, have called for expansion of the standing rules to permit enforcement by certain members of the public. The argument is that since attorney general enforcement is weak and this is unlikely to change, the only recourse is to let others take on that role. Under existing law, as noted, it is only in a few limited circumstances that individuals have standing to seek correction of abuses of fiduciary duties by charitable directors and trustees. UMIFA permitted donors to release restrictions; UPMIFA permits them to agree to modifications. The Uniform Trust Code, promulgated by the Commissioners on Uniform State Laws in 2000, went much further, reversing common law precedent by permitting donors to sue to enforce the terms of their charitable gifts. By October 2007, this law had been adopted in 19 states and it was likely to be accepted even more broadly in the ensuing years.

Under common law principles, co-trustees and directors do have standing to correct abuses, and there are a few cases in which the courts have permitted other
interested parties such as hospital patients, park abutters and alumni to bring suit. A major factor in the decision to permit suit by an interested party to proceed has been the absence of any state official able or willing to act. As noted above, under common law in some states, and by statute in others, attorneys general may appoint relators to bring enforcement actions in his name, most often with the relators bearing the cost of litigation. In fact, Zollmann describes this as the proper form of action when the attorney general is the plaintiff. “A private relator is important in such a case for the reason that someone must be responsible for costs if it appears that the information is unfounded.”

I am opposed to expanding standing as a general rule, both to donors and to members of the general public. This recommendation is narrowly framed and would permit intervention in suits only in those situations where the attorney general is a necessary party to the action and either believes he is conflicted from participating or for other reasons chooses not to participate.

**AMEND THE UNIFORM SUPERVISION OF TRUSTEES FOR CHARITABLE PURPOSES ACT TO CORRECT AMBIGUITIES AND REFLECT CURRENT REGULATORY NEEDS:** The Uniform Supervision of Trustees for Charitable Purposes Act needs to be amended if it is to be a meaningful precedent for new regulatory programs. The most serious shortcoming, one that led to subsequent amendment of the act in states which had adopted it (notably Michigan and Illinois) is its failure to explicitly include charitable corporations in its coverage. Another serious limitation is the breadth of charities exempt from the filing provisions, notably those with educational and hospital purposes. The act also fails to identify those suits in which the attorney general should be considered a necessary party, as well as those in which he should be a proper

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29 Zollmann, *supra* note 2 at 429.
party. Further, the act should contain provisions requiring notice to the attorney general of a substantial contraction of assets, of dissolutions (if not under court supervision – a far better procedure) and of mergers.

In 2004 the Commissioners established a Study Committee on Regulation of Charities to consider whether any future action should be taken on this subject. At their request, Prof. Laura Chisolm of Case Western Reserve Law School analyzed whether the Uniform Act needed revision, and if so, how to improve it, and whether revision would be politically feasible. In addition to the shortcomings mentioned above, she noted the lack of guidelines for attorney general action in the context of interstate or multi-state issues and the fact that the act has not kept up with drastic changes in related laws affecting charities, notably the overriding importance of federal tax law. She concluded that with appropriate revision, it could serve as a useful model for states that have nothing on the books, while noting that the needed reforms seem less likely to rally the support of attorneys general, so that the issue may stay in the realm of “academic pondering”. 30 In August 2007, the Executive Committee of NCCUSL voted to establish a drafting committee on the regulation of charities to consider four specific topics: codification and articulation of attorney general authority over charitable assets, whether held in trust or owned outright by charitable corporations; specification of transactions and legal proceedings that require notice to an attorney general; articulation of attorney general investigatory powers and available remedies; development and codification of principles to guide attorneys general in regard to interstate and multi-state problems, and encouragement of collaboration among attorneys general. The drafting committee was

Paper on file with author.
directed to hold a "stakeholder" meeting, after which it was to report to the Executive Committee.

AMEND SUBSTANTIVE LAWS TO ACHIEVE UNIFORMITY AND CLARITY AND ASSURE THAT PENALTIES FOR BREACH OF DUTY PROVIDE MEANINGFUL DETERRENTS: Efforts to improve attorney general oversight of charities will be meaningless if the laws that regulators are directed to enforce are ineffective to correct abuses. This is, unfortunately, the case in many jurisdictions. There are several aspects to the problem. The first is that, in many states, charity law is virtually non-existent and courts, unsure as to the extent of their power to correct abuses, are often reluctant to act. When they do, furthermore, they are likely to turn to business laws for precedents, regardless of the fact that these laws are not appropriate in the context of nonprofit organizations. Second, in many jurisdictions, it is unclear whether and in what circumstances trust law or corporate law is to apply in defining fiduciary duties as well as the disposition of charitable assets.

There have been calls in the literature since the early 1960s for the adoption of one law of charity, although this view is not universally supported. In fact, some commentators argue that two standards should be preserved with donors permitted to choose the one they prefer. Although there may be merit to this position in terms of the laws governing the creation and operation of charities, changes of purposes, and application of the doctrines of cy pres and deviation, it is difficult to justify when the issue is the definition of fiduciary duties and the sanctions to be applied when they are abused.
Finally, in many of the jurisdictions in which charity law is well defined, during the last twenty-five years, legislatures have relaxed the standards for charitable fiduciaries, expanded the circumstances under which they can be indemnified and, in some jurisdictions, permitted them to provide fiduciaries with complete immunity from suit by adopting liability shields. The American Law Institute project on Principles of the Law of Nonprofit Organizations, inaugurated in 2002 has already had an important impact on the development of a uniform law of charity. It promises to be the most likely means by which this will be accomplished in the future.

**ARTICULATE THE LIMITS ON THE OVERSIGHT ROLE OF THE ATTORNEY GENERAL SO THAT THE PUBLIC WILL UNDERSTAND AND RESIST WHEN THEY ARE BREACHED:** This is an amorphous recommendation and, undoubtedly one that will be difficult to achieve. Yet, the need is apparent, and other than public outcry and resistance, there does not seem to be an easy remedy. There is a role here for the press, as well as individual legislators who in certain circumstances can act as spokesmen for the charitable sector. Happily, although the examples are striking, they are not indicative of wide-spread overreaching and one can hope that this will continue to be the case.

**RELATIONSHIP OF FEDERAL AND STATE OVERSIGHT**

A major drawback to effective state action is the absence of meaningful cooperation between state officials and the IRS in connection with specific matters. This has been the case despite the fact that section 6104(c), enacted as part of the Tax Reform Act of 1969 contained a provision specifically authorizing the IRS to notify state charity regulators with respect to determinations relating to the denial or revocation of tax
exemption of charities in their jurisdictions. Prior to this, the IRS was empowered to
exchange information only with state tax officials. However, Treasury regulations
promulgated under this section effectively undermined the statute by interpreting
“determination” to mean a final determination, which meant that no information could be
provided until all administrative review was completed, at which time it would inevitably
be far too late for a state agency to take action to effectively protect charitable assets.

Legislation to correct this shortcoming has long been recommended by Congress,
the GAO and state regulators. It was adopted as part of the Pension Protection Act of
2006. However, there are still obstacles to free exchange of information. The new statute
requires a request from the state official before the IRS can provide any information. Of
course, if the federal matter has been privileged, it is the rare instance case in which a
state regulator will have information sufficient to make the request.

FEDERAL LAW CHANGES DESIGNED TO IMPROVE STATE OVERSIGHT

Even if one concludes that state oversight is inappropriate because it is
ineffective, or because it is overreaching and thereby serves to restrict, not enhance,
charitable activity, it is difficult to envision the outcome should there be full federal
preemption of charity regulation. This is not to say that it would be impossible to create a
federal law of charity nor even to require all charities to be organized under a federal
enabling statute. However, for the immediate future, I do not envision such a
development, nor do I think it would be advisable.

I believe that determining donor intent, framing cy pres and deviation schemes,
and applying sanctions for breach of fiduciary duties are an appropriate function of courts
that are familiar with local situations and local needs. Naturally, they will be asked to adjudicate issues that are not local, but those will be a small fraction of the cases and there is no evidence that they are incompetent to do so. Finally, to the extent that uniformity is needed for federal purposes, this can be achieved through Code provisions and Regulations such as those found in Section 508 and in the Organizational Test for tax exemption under which trust instruments and corporate articles of organization must include language limiting powers and purposes and assuring that on dissolution assets will be transferred to other qualified exempt entities.

Accepting that we will for the present retain two levels of oversight, it is prudent to consider measures that will improve coordination of federal and state regulation. The need to expand the ability of the IRS to provide information to state regulators has already been discussed. However, there are two other federal changes that would greatly enhance current oversight.

The first would be to expand the power of the IRS to abate federal penalties if states have acted to protect charitable funds. This power already exists in regard to private foundations. It is to be found in section 507 under which abatement of the confiscatory termination tax on private foundations is permitted if there has been state action to preserve the charitable assets. A case can be made for mandating abatement where the state has preserved assets and imposed penalties, but at the least the IRS should be empowered to so act.

The positive effects of abatement are exemplified in a controversy involving the Massachusetts Attorney General and the Paul and Virginia Cabot Charitable Trust, a Massachusetts charity that was the subject of an article in the Boston Globe in 2003 in
which the managing trustee admitted to diverting several million dollars from the trust for his own personal purposes. In 2004 the attorney general’s office announced that the trustee had agreed to repay the foundation more than $4 million. However, in 2006 the attorney general's office reported that it had collected only $900,000 because the IRS had claimed a large part of the settlement amount as fines for self-dealing. Subsequently, some of the trustee’s children claimed part of his assets, threatening litigation to preserve their inheritance. Rather than become involved in a family dispute which would have entailed large legal fees and diversion of his limited staff from other matters, the Attorney General agreed to the compromise.

The second change that would improve federal and state regulatory efforts, a measure supported by the Panel on the Nonprofit Sector, that also has a precedent in Chapter 42. Section 508(e) of the Code conditions tax exemption for a private foundation on inclusion in its governing document of a provision requiring compliance with the limitations on private foundation operations contained in Chapter 42, including a specific prohibition on foundation managers entering into any self-dealing transactions prohibited in that chapter. Instead of requiring inclusion of the requisite language in articles of organization or trust documents, regulations adopted in 1972 provide that the governing instrument requirement can be met if a valid state law imposes these obligations on all private foundations within its jurisdiction. By 1975 forty-eight states and the District of Columbia had passed such laws. These statutes provide state regulatory officials with grounds for prosecuting failures to comply with federally imposed rules, an unprecedented example of coordination of the two regulatory schemes.

32 Katz, supra note 25.
Under the Panel’s proposal, a similar provision would apply to all publicly supported charities (the remaining universe of organizations exempt under section 501(c)(3)), requiring compliance with the Excess Benefit provisions in Code section 4958.33 Maine adopted such a provision in its 2002 charities act and the Massachusetts attorney general in 2005 supported its adoption in that state, although the bill was not passed.34

Opponents of this legislation note that there are no reported instances in which a state has taken legal action against a private foundation solely on the grounds of failure to comply with these state provisions. This does not mean that the prohibitions have not served as a deterrent, nor that threat of state litigation has not resulted in corrections. At best, it provides one more weapon for regulators and contributes to uniformity among the states.

CONCLUSIONS

Looking to the future of attorney general oversight, at the outset one must question the rationale for requiring charities to report to both the IRS and to state agencies. With electronic filing of Form 990 about to be implemented, there should be no need for this duplication. It is true that the reporting threshold for states and the IRS differ; nonetheless, at least as to those charities that are currently subject to dual reporting, the states should be able to get information from a federal clearing house. This will require greater coordination among the states and the IRS, as to both content and

coverage, a development that, as already noted, is to be encouraged in all events. This change would be equally important if, as discussed below, federal oversight was removed from the IRS.

A second issue as we look to the future is the role of state oversight if federal regulation of charities were to be lodged in a newly created federal agency. A proposal for such a new agency has been suggested by Marcus Owens, former director of the exempt organizations division of the IRS and is being considered by state and federal regulators, scholars, legislators and practitioners alike. When combined with the recommendations of the staff of the Senate Finance Committee that the federal courts be granted equity powers similar to those held by the state courts, one is forced to reconsider the appropriate role for state regulation. The answer would, in part, depend on the framework adopted, including whether and to what extent the IRS would continue to have regulatory powers. However, I believe the argument for a local voice in enforcement of fiduciary duties and application of the doctrines of cy pres and deviation remains compelling.

When one considers regulation of solicitation, I believe a strong case can be made for federal preemption at least of the information gathering function. In the 1970s I recommended to the Filer Commission that responsibility for regulating charitable solicitations be lodged with the Federal Trade Commission with which soliciting charities would be required to register and file reports regarding that aspect of their activities. Today, the FTC remains an appropriate situs to consider, particularly in light of the fact that it currently regulates for-profit entities that solicit for charities, notably telemarketers. I believe such a change would be particularly important if the IRS is to
retain its existing role as regulator of tax exempt charities, primarily because fundraising
activities cannot be effectively policed through the Code, and accordingly the IRS is not
constituted to regulate them effectively. However, if a newly created agency for charity
regulation should be established, it should have the broadest oversight powers, and if this
were to come about, I would support including regulation of solicitations among those
powers.

Prof. Renee A. Irvin in 2005 put forth a contrary view of state regulation of
solicitation. Specifically, she questioned the efficacy or registration and reporting
requirements as a fraud detection methodology and suggested that state regulators would
do better to concentrate on correcting abuses brought to their attention by consumers. She
noted, further, that information now required by the states can be obtained through
national clearing houses. Irvin’s study focused exclusively on statutes regulating
solicitation. It did not consider the impact of the broader registration and reporting
requirements in states such as New York, Ohio and Illinois where oversight is focused on
abuse of fiduciary duties in addition to fraudulent or misleading solicitations.35 Reliance
on consumer complaints cannot provide the information needed for oversight of this
nature. However, this does not mean that the states need to continue to require duplicate
separate reports.

If state registration and reporting requirements are to be eliminated, one would
have to be assured that information necessary for their oversight purposes is available to
state regulators. The natural source for information is, of course, IRS, but there would
have to be some assurance that it would ask the right questions. It will also be important

35 Renée A. Irvin, “State Regulation of Nonprofit Organizations: Accountability Regardless of Outcome”,
34 Nonprofit and Voluntary Sector Quarterly 161 (2005).
to determine an appropriate threshold for reporting. As of 2007, the IRS reporting threshold for Form 990 filing is annual gross receipts of $25,000, but it is very possible that this amount will be increased, particularly with adoption of a revised form 990. The inclusion of extensive questions on governance practices in the revision of that form released for public comment by the IRS in spring of 2007, signals a new focus for IRS regulation closer to the interest of the states than heretofore, so this may be an appropriate time to consider state law revisions. If ultimately federal oversight is moved to a new agency, the issues will be the same and the need for coordination of federal and state oversight equally pressing.

Another contrary view of state oversight has been voiced by Prof. James Fishman, who has questioned whether attorneys general are the right officials to exercise oversight of charities or whether this power would better to be placed under the jurisdiction of a new state regulatory agency similar to the British Charity Commission. This mirrors, of course, on a state by state basis, proposals for a new federal agency. I suggest that the chances for adoption of such a change are extremely slight, given the current lack of interest in the vast majority of states in increasing any sort of regulation. Furthermore, if the primary purpose of such a move is to decrease politicization, one need be concerned that a new body might be far less insulated than an attorney general.

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37 Although it is beyond the scope of this paper, it should also be noted that there are a number of state agencies other than the office of the attorney general that have a role in charity oversight. Most visible are the departments of education and health that, through their roles in accreditation and licensing, have broad regulatory powers, although they are not necessarily focused directly on breaches of fiduciary duty. The New York state Board of Regents is an example of a state regulatory body does monitor fiduciary duties, as was illustrated in its case against the trustees of Adelphi University that resulted in removal of almost an entire board and imposition of heavy fines for engaging in self-dealing transactions. State, as well as federal, agencies with which charities contract also regulate to varying degrees the operations and governance of their grantees or the parties to their contracts. State anti-discrimination laws also may impact the operations of certain charities and, of course, state tax statutes have a limited effect. None, however,
As we consider any of these reforms, it is important to realize that we have no accurate knowledge of the extent of abuse by charitable fiduciaries. Similarly, we do not know the extent of abuse of power by attorneys general. One is forced, therefore, into a balancing act in which one tries to adopt the least intrusive standards, while signaling to fiduciaries that they will be held to those standards and assuring the public that funds dedicated for their ultimate benefit are not being diverted for private purposes nor being administered recklessly. Furthermore, the public, including the charitable sector, needs to be assured that the officials who provide oversight are mindful of the limits to their powers and that, ultimately, overreaching will not be tolerated --- a large, but one can hope, not insurmountable task.