

First Supplement to Memorandum 88-65

Subject: Study L-3012 - Uniform Management of Institutional Funds Act
(Comments of Attorney General)

We have received a letter from Deputy Attorney General James R. Schwartz commenting on the draft recommendation to expand coverage of the Uniform Management of Institutional Funds Act [UMIFA]. (See Exhibit 1.) In summary, Mr. Schwartz questions the need for and advisability of extending UMIFA to all eleemosynary organizations, and argues that UMIFA should not be extended "without a detailed and comprehensive evaluation of the risks involved."

Experience Under UMIFA

Mr. Schwartz writes that "it is crucial to determine whether the institutions which have availed themselves of this system have, in truth, benefitted from its provisions." Our telephone conversations with financial officers and representatives of institutions covered by the act indicate that they have found it quite valuable. They are concerned that UMIFA not be restricted or impaired. We hope that we will receive some input from these organizations that assesses their experience under UMIFA. Presumably the repeal of the sunset clause in 1978 indicates a positive experience up to that time. The staff does not believe that there is any reason to suspect that private educational institutions have not benefitted from the provisions of UMIFA. In any event, UMIFA is not mandatory. If an organization does not wish to take advantage of any of its provisions, it need not do so.

Expansion to Less Sophisticated Organizations

There is a concern that expansion of UMIFA to cover "smaller, less financially sophisticated charitable organizations may create substantial long-term problems." The staff assumes that this refers to the possibility that a smaller or less sophisticated organization might sacrifice its future security in pursuit of short-term goals. On the

other hand, the flexibility provided in UMIFA might permit a small organization to use appreciation to survive a present hardship so that there is a future.

It would be interesting to know the experience in the other 28 states that have not restricted UMIFA as has California. The absence of statutory restrictions in other jurisdictions, reported decisions, and scholarly commentary leads the staff to conclude that this concern is not well-founded. If the expressed concern can be made more specific and concrete, perhaps the statute can be revised to meet the concern. For example, the Commission could recommend that the expansion of UMIFA be limited by a five-year sunset provision, as was the original enactment in California.

The staff wonders what the organizations not covered by UMIFA are doing now. We suspect that some organizations may use all but the most restrictive endowments as they wish -- in effect, a self-help UMIFA. Extending the California version of UMIFA to these organizations would provide a more protective, more regular procedure than what they might be doing now.

Standard of Care

Mr. Schwartz states that they are "also extremely concerned with the UMIFA standards of care" and notes that these standards differ significantly from the provisions of the Corporations Code. The staff is not clear what their concern is.

As to the difference between UMIFA and the Corporations Code, this is not a new situation, since it exists for private educational institutions currently covered by UMIFA. The law applicable to charitable, religious, and eleemosynary institutions cuts across the law applicable to public benefit corporations, mutual benefit corporations, and religious corporations. This is unavoidable because some organizations are incorporated and some are not. In addition, the oversight power of the Attorney General disregards the fact that the organization may be incorporated.

The staff is also unclear on the objection to the standard of care provided in the California version of UMIFA. (See Section 18506 in the draft recommendation attached to Memorandum 88-65.) The standard is

generally consistent with the corporate standard. For example, as to public benefit corporations, Corporations Code Section 5231 provides that the director shall perform duties "in good faith, in a manner such director believes to be in the best interests of the corporation and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances." This standard also applies to mutual benefit corporations under Corporations Code Section 7231. A similar standard applies to directors of religious corporations under Corporations Code Section 9241.

Cy Pres and Releasing Restrictions in Gift Instruments Under UMIFA

Mr. Schwartz is "extremely concerned" with the provision for releasing restrictions in gift instruments. (See Section 18507 in the draft recommendation attached to Memorandum 88-65.) He writes that the standards in UMIFA for altering the restrictions are "significantly different from the cy pres rules currently in existence."

The official comment to this provision in the uniform act explains that this provision is intended to provide

an expeditious way to make necessary adjustments when the restrictions no longer serve the original purpose. *Cy pres* has not been a satisfactory answer and is reluctantly applied in some states. . . .

. . . .
This section authorizes only a release of a limitation. Thus, if a fund were established to provide scholarships for students named Brown from Brown County, Iowa, a donor might acquiesce in a reduction of the limitation to enable the institution to offer scholarships to students from Brown County who are not named Brown, or to students from other counties in Iowa or to students from other states, or he could acquiesce in the release of the restriction to scholarships so that the fund could be used for the general educational purposes of the school.

Subsection (d) makes it clear that the Act does not purport to limit the established doctrine of *cy pres*. . . .

(See Exhibit 2 to Memorandum 88-65, at 723-24.)

Once again, we are not clear on the nature of the objection to this provision. As noted, it operates only to remove a restriction and requires donor consent or approval of a court pursuant to a standard. The gift must remain devoted to the purposes of the donee institution.

The release power does not interfere with *cy pres*. We do not believe that the doctrine of *cy pres* is so definite and rigid that it would conflict with this provision. (See generally 7 B. Witkin, *Summary of California Law Trusts* §§ 49-50, at 5411-14 (8th ed. 1974).

Respectfully submitted,

Stan G. Ulrich
Staff Counsel

EXHIBIT 1

JOHN K. VAN DE KAMP
Attorney General

State of California
DEPARTMENT OF JUSTICE



350 McALLISTER STREET, ROOM 6000
SAN FRANCISCO 94102
(415) 557-2544

(415) 557-1664

September 26, 1988

Stan Ullerich
California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, CA 94303-4739

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SEP 27 1988
M.M.WOOD

Dear Stan:

Re: Memorandum 88-65; Study L-3012
Uniform Management of Institutional Funds Act ("UMIFA")

This is to acknowledge receipt of your August 29, 1988 letter, with the above-mentioned study attached. We appreciate the opportunity to provide input with respect to this issue.

The Office of the Attorney General has a number of questions and concerns regarding the expansion of UMIFA to all charitable and eleemosynary organizations in California. While UMIFA has been in effect in this state for approximately 15 years (as applied to certain accredited private colleges and universities), we have not seen any studies or data which consider the financial effects of the Act in practical terms. Prior to expanding the scope of the law, we feel that it is crucial to determine whether the institutions which have availed themselves of this system have, in truth, benefitted from its provisions. Alternatively, we feel it important to consider whether the increased volatility of the stock markets creates increased (and perhaps unwarranted) long-term risks to organizations which expend unrealized gains. Similarly, we are concerned that the expansion of the Act to smaller, less financially sophisticated charitable organizations may create substantial long-term problems.

We are also extremely concerned with the UMIFA standards of care (which differ significantly from the provisions in the Calif. Corp. Code) and with the provisions for releasing restrictions in gift instruments. The standards in UMIFA for altering the express terms of a trust are significantly different from the cy pres rules currently in existence.

Stan Ullerich
September 23, 1988
Page 2

While we are not unalterably opposed to a modification of the current system, we do not feel that such significant changes should be made without a detailed and comprehensive evaluation of the risks involved.

Very truly yours,

JOHN K. VAN DE KAMP
Attorney General

JAMES R. SCHWARTZ
Deputy Attorney General

JRS:ft