#L-3012

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01/25/89

Memorandum 89-13

Subject: Study L-3012 - Uniform Management of Institutional Funds Act (Reconsideration of Draft Tentative Recommendation)

At the December meeting, the Commission approved in principle the proposal to extend the Uniform Management of Institutional Funds Act to cover all educational, religious, charitable, and other eleemosynary institutions. Further consideration was postponed, however, to provide time to respond to the concerns expressed by the Attorney General's office and to research the legislative history of and current interpretation given the provision concerning appropriation of "net appreciation, realized in the fair value of the assets of an endowment fund over the historic dollar value." (See draft Section 18502.)

The proposal to extend the coverage of UMIFA is supported by the following:

1. Jonathan A. Brown, Vice President of the Association of Independent California Colleges and Universities, which are currently covered by UMIFA. (Letter attached to Second Supplement to Memorandum 88-65, on agenda at December meeting; a follow-up letter from Mr. Brown is attached as Exhibit 4, at exhibit pp. 30-32.)

2. Herbert J. Paine, Executive Director of United Way of California, whose associated institutions could benefit from the proposed expansion. (Letter attached to Second Supplement to Memorandum 88-65.)

3. William J. Wood, Executive Director of the California Catholic Conference, which would be covered by the proposed expansion. (Letter attached to Third Supplement to Memorandum 88-65.)

4. The State Bar Committee on Nonprofit Corporations of the Business Law Section unanimously supported expansion of UMIFA as proposed in the draft. (Letter from Committee Chair John W. Francis, attached to December Minutes.)

The proposal is opposed by the following:

1. Deputy Attorney General James R. Schwartz, on behalf of the Attorney General's office. (Letters attached to the First and Fourth Supplements to Memorandum 88-65; the second of these letters is reproduced as Exhibit 2, at exhibit pp. 24-26.)

2. Kathleen V. Fisher, on behalf of the Marin Community Foundation, one of the cotrustees of the Buck Trust. (Letter attached as Exhibit 3, at exhibit pp. 27-29.)

This memorandum reviews the main objections raised by Mr. Schwartz and Ms. Fisher. Additional matters are discussed in notes following relevant sections in the draft tentative recommendation which is attached to this memorandum.

Cy Pres Doctrine

The major concern expressed by Mr. Schwartz at the December meeting involved the so-called *quasi cy pres* rule of UMIFA Section 7. This provision permits the release of restrictions imposed on the use or investment of an institutional fund with the written consent of the donor or, if the donor is dead, disabled, unavailable, or cannot be identified, with the approval of a court. Under the uniform act, court release of a restriction requires a finding that the restriction is "obsolete, inappropriate, or impracticable." A release may not allow a fund to be used for purposes other than the educational, religious, charitable, or other eleemosynary purposes of the institution holding the funds. Nor may a donor consent to change the endowment nature of the funds. This limited doctrine is not intended to affect the application of traditional *cy pres* rules. It should also be remembered that this rule involves only the release of a restriction, and not the change of a charitable purpose or a switch of institutions.

California has adopted this UMIFA provision with one important change. The official text of UMIFA permits the court to release a restriction if it finds it to be "obsolete, inappropriate, or impracticable." Although the uniform act was introduced in California with its official text, the bill was amended to delete the word "inappropriate." (1973 Senate Bill 1140, as amended in Assembly, Sept. 10, 1973, enacted as 1973 Cal. Stat. ch. 950, § 1.)

Mr. Schwartz has criticized this existing rule in his letters and in his remarks at the December meeting. His arguments are mainly directed against the obsolete standard, which he has characterized as a matter of fashion, such as the width of one's necktie. He has also argued that the impracticable standard is overly broad.

The staff recommends continuing the standard of existing law. The Attorney General's office has not shown a need to change existing law in this respect. They have not shown any unacceptable results arising under either the obsolete or the impracticable standard in California or any other jurisdiction.

Mr. Schwartz has argued that the (existing) UMIFA standard would disrupt the settled law of *cy pres* in California. The lament of the court in *Estate of Loring* (cited approvingly by Mr. Schwartz) is instructive in this connection: "The *cy pres* doctrine has meant many things to many courts and its limits have rarely been defined." (29 Cal. 2d at 436) It should also be noted that the Restatement rule is not limited to illegality or impossibility, but also includes impracticability. The "impracticable" standard is a well-established part of the *cy pres* rule. See Restatement (Second) of Trusts § 399 (1957); Estate of Loring, 29 Cal. 2d 423, 436, 175 P.2d 524 (1946); Estate of Mabury, 54 Cal. App. 3d 969, 984-85, 127 Cal. Rptr. 233 (1976); Society of California Pioneers v. McElroy, 63 Cal. App. 2d 332, 337-38, 146 P.2d 962 (1944). Comment *q* to Section 399 of the Restatement (Second) of Trusts reads in part as follows:

> The doctrine of cy pres is applicable even though it is possible to carry out the particular purpose of the settlor, if to carry it out would fail to accomplish the general charitable intention of the settlor. In such a case it is "impracticable" to carry out the particular purpose, in the sense in which that word is used in this Section. This is particularly likely to be the case where there has been a change of circumstances after the creation of the trust. . . .
>
> Thus, if a testator bequeaths property in trust to establish and maintain an institution of a particular kind, and owing to the fact that a similar institution already exists, or is subsequently created, so that to establish or to maintain the institution as directed by the testator would serve no useful purpose, the court will not compel the trustee to establish or maintain the institution.
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> So also, if a settlor establishes a school and directs that certain subjects only shall be included in the

> curriculum, and in course of time this restriction prevents the school from affording a proper education, the court will permit changes in the curriculum.
>
> So also, the directions of the settlor with respect to the mode of government or the conduct of an institution created by him may be dispensed with by the court, where these directions seriously impede the usefulness of the institution.

The staff does not see a crucial difference between the concept of impracticability as here outlined and the concept of obsolescence. Nor, more importantly, do we see a persuasive policy reason for requiring the continuance of obsolete and impracticable limitations. Finally, it should also be remembered that under UMIFA we are concerned only with removing certain limitations on gifts to specific institutions. Unlike the doctrine of *cy pres,* the UMIFA provision for releasing restrictions does not permit selecting a different charitable organization to receive the gift.

The staff also senses that there is some confusion about the status of the *quasi cy pres* rule in UMIFA. The standard for court release of a restriction under Section 18507 in the draft tentative recommendation is the same as existing Education Code Section 94607 and its predecessor, former Civil Code Section 2290.7. The staff is not proposing a new standard. The words "obsolete or impracticable" are in existing law. (The only revision in this section proposed by the staff was to change the phrase "modify any use of" to "release a restriction on" in the second sentence of subdivision (b) for internal consistency and uniformity.) The draft provision is thus not a radical new proposal designed to gut *cy pres.* In short, the staff cannot understand the vociferous opposition of the Attorney General's office on this point.

In this connection, we have also received a letter from Kathleen V. Fisher, on behalf of the Marin Community Foundation, one of the cotrustees of the Buck Trust. (See Exhibit 3, at exhibit pp. 27-29; we have not reproduced the 167 pages of supporting materials forwarded with this letter.) Ms. Fisher reports that the Marin Community Foundation "opposes the proposed changes to Section 18507 of the UMIFA, which would alter the legal standard to determine whether to release a restriction in a gift instrument." Ms. Fisher writes:

> After three and one-half years of expensive litigation over the San Francisco Foundation's petition, the Court refused to release the geographic restriction of the Trust. I am enclosing a copy of the Court's Statement of Decision. The Court found that even if the increase in the size of the Trust had made the geographic restriction obsolete, the *cy pres* doctrine could not be used to release that restriction for the benefit of those outside of the county whose needs were arguably greater.
>
> The standard proposed in Section 18507, allowing a court to release a restriction if it is "obsolete or impracticable," replicates the standard rejected by the Court in the Buck Trust litigation. The Court found that such a standard would violate the sanctity of a testator's charitable intent and vest too much discretion in a court or a trustee over whether to release a restriction in a charitable trust. The current *cy pres* doctrine promotes the continuity and stability of charitable trusts. The standard proposed in Section 18507 would both hinder charitable gift-giving and impede the administration of established trusts. The word "obsolete" is too vague to ensure a charitable donor that his gift will be a lasting legacy to his chosen beneficiaries. Indeed, this imprecise standard will discourage donors from making charitable gifts.

The staff has examined the materials cited by Ms. Fisher and cannot agree with her argument that the court was rejecting the sort of standard expressed in draft Section 18507. For one thing, the word "obsolete" does not appear in the court's statement of decision. In the Buck Trust litigation, the San Francisco Foundation argued that it was "impracticable, inexpedient, and inefficient" to comply with the restrictions of the will. The court rejected this standard and applied a *cy pres* standard expressed as "illegal, impossible, or permanently impracticable of performance" to reject the petition to remove the Marin-only restriction.

Does draft Section 18507 threaten the result reached in the Buck Trust case? There are several aspects to this question. The first is whether there have been problems involving the educational institutions which have been subject to this rule for the past 16 years. We are not aware of any problems. Nor has the Attorney General's office shown cases where application of the UMIFA standard has been a problem in California or any other jurisdiction. It should be understood that if it were not California law, the staff would not necessarily be suggesting inclusion of the "obsolete" standard in this provision, just

as we have not recommended reviving the "inappropriate" standard, which was deleted from the bill in 1973. However, "obsolete" is in existing law, and we have not seen any reason to repeal it.

Second is the question of what "obsolete" would mean in this context. "Obsolete" is certainly a stricter standard than "inexpedient" or "inefficient" which were proposed in the Buck Trust case. Without fully briefing the question, "obsolete" seems to be somewhere between impracticable and inexpedient. Ms. Fisher wishes to avoid further litigation involving the Buck Trust. We understand that she and her colleagues would want to argue at length over the meaning of yet another word. However, we do not know that the obsolete standard of existing law would engender any such litigation.

The staff is open to compromise. Just as we are unaware of any problems caused by the obsolete standard, we do not know of any concrete benefits that have flowed from it. As an overall policy, the staff accepts the reasoning of the Uniform Law Commissioners as stated in the introductory comment to UMIFA. (See Exhibit 1, at exhibit pp. 5, 19-20.) We think it is entirely appropriate to have a slightly less restrictive *cy pres* rule governing restrictions on endowment funds held by eleemosynary institutions. However, the utility of UMIFA would not be significantly impaired if the "impossible or impracticable" standard were to be substituted for the "obsolete or impracticable" standard in existing law.

Relationship Between UMIFA and Corporations Code

The attached draft has been revised to clarify the relationship between UMIFA and any applicable provisions in the Corporations Code. We view this as a technical matter, involving improvement of existing language. We do not accept the suggestion put forth by the Attorney General's office that there is a broader substantive conflict that militates against broadening the application of UMIFA. Once again, we note that even with the existing language, it has apparently not been a problem for educational institutions covered by the California statute. To suggest that a new set of problems will arise from expanding the coverage of the act is to postulate chimaeras.

Expansion of UMIFA would have the effect of clarifying the duties

and powers of governing boards that are not incorporated. Furthermore, it can be said with confidence that the standards of the California version of UMIFA, even if they overrode the Corporations Code, would not be significantly different. Compare the language of the following provisions:

Nonprofit Public Benefit Corporation Law

Corp. Code § 5231

(a) A director shall perform the duties of a director, including duties as a member of any committee of the board upon which the director may serve, **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.**

(b) [Reliance on investment advice.]

(c) Except as provided in Section 5233 [self-dealing], a person who performs the duties of a director in accordance with subdivisions (a) and (b) shall have no liability based upon any alleged failure to discharge the person's obligations as a director, including, without limiting the generality of the foregoing, any actions or omissions which exceed or defeat a public or charitable purpose to which a corporation, or assets held by it, are dedicated.

California Version of UMIFA

Draft § 18506

(a) When investing, reinvesting, purchasing, acquiring, exchanging, selling, and managing property, appropriating appreciation, and delegating investment management for the benefit of an institution, the members of the governing board shall act with the care, **skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of like character and with like aims to accomplish the purposes of the institution.** In the course of administering the fund pursuant to this standard, individual investments shall be considered as part of an overall investment strategy.

(b) In exercising judgment under this section, the members of the governing board shall consider the long and short term needs of the institution in carrying out its educational, religious, charitable or other eleemosynary purposes, its present and anticipated financial requirements, expected total return on its investments, general economic conditions, the appropriateness of a reasonable proportion of higher risk investment with respect to institutional funds as a whole, income, growth, and long-term net appreciation, as well as the probable safety of funds.

On the other hand, the uniform act provides a standard of "ordinary business care and prudence" that differs from California's nonprofit corporation statutes and California's UMIFA rule:

UMIFA Official Text

Section 6

In the administration of the powers to appropriate appreciation, to make and retain investments, and to delegate investment management of institutional funds, members of a governing board shall exercise **ordinary business care and prudence under the facts and circumstances prevailing at the time of the action or decision.** In so doing they shall consider long and short term needs of the institution in carrying out its educational, religious, charitable, or other eleemosynary purposes, its present and anticipated financial requirements, expected total return on its investments, price level trends, and general economic conditions.

The "ordinary business care and prudence" language was replaced by a trust standard ("judgment, care and prudence . . . which men of discretion and intelligence exercise in the management of their affairs") by amendment in the Assembly during passage of the original bill in 1973. Although California thus rejected another progressive aspect of UMIFA, the staff has not suggested that the uniform language be adopted because California trust law has become more flexible over the years and the California version of UMIFA was conformed to trust principles when the Trust Law was enacted.

Mr. Schwartz states that they are "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 still not clear on the nature of the concerns of the Attorney General's office.

As to the differences 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. However, it should be remembered that the oversight power of the Attorney General disregards the fact that the organization may be incorporated.

Expenditure of Unrealized Gains

UMIFA was an attempt to clarify and modernize the law concerning governing boards of eleemosynary institutions. The applicable law was viewed as being in doubt or unnecessarily restrictive through application of rigid private trust principles, particularly in some eastern states. UMIFA adopted some concepts from newly developed statutes concerning the authority and liability of directors of nonprofit corporations. Another major concern was that governing boards should have appropriate authority to effectively further the charitable, educational, religious, or other eleemosynary purpose of their institutions. Hence, UMIFA proposed rules to enable governing boards to use a total return concept in investing their endowment funds and provided a procedure akin to *cy pres* for releasing some restrictions on the use of funds or selection of investments by donor consent or court action.

The purpose of allowing flexible investment decisions, however, was impaired in 1978 when the authority to appropriate unrealized appreciation was deleted from Civil Code 2290.2. On its face, this amendment requires sale of an asset to realize its appreciation and be able to take advantage of UMIFA. The original act sought to permit institutions to create a balanced investment portfolio, but as amended in 1978, again tempts governing boards to favor current yield over long-term growth. As explained in the Prefatory Note to UMIFA:

> [T]oo often the desperate need of some institutions for funds to meet current operating expenses has led their managers, contrary to their best long-term judgment, to forgo investments with favorable growth prospects if they have a low current yield.
>
> [I]t would be far wiser to take capital gains as well as dividends and interest into account in investing for the highest overall return consistent with the safety and preservation of the funds invested. If the current return is insufficient for the institution's needs, the difference between that return and what it would have been under a more restrictive policy can be made up by the use of a prudent portion of capital gains.
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> [7A U.L.A. 707, quoting W. Cary & C. Bright, The Law and the Lore of Endowment Funds 5-6 (1969).]

As if anticipating the California variation, the Prefatory Note argues as follows:

> The Act authorizes the appropriation of net appreciation. "Realization" of gains and losses is an artificial, meaningless concept in the context of a nontaxable eleemosynary institution. If gains and losses had to be realized before being taken into account, a major objective of the Act, to avoid distortion of sound investment policies, would be frustrated. If only realized capital gains could be taken into account, trustees or managers might be forced to sell their best assets, appreciated property, in order to produce spendable gains and conceivably might spend realized gains even when, because of unrealized losses, the fund has no net appreciation.

It should also be remembered that if gains are not used as determined by the directors of an eleemosynary in furtherance of its purposes, but are merely accumulated, when the charity terminates, the gains may go to a different charity and a different purpose, under *cy pres*. Those who place a great reliance on the donor's intent should consider whether the dead hand is honored by such a rule. Is it better to hold appreciating assets safe from any use only to be disposed of in some future decade by a court applying *cy pres* doctrine, or to rely on the directors who are charged with fulfilling the charitable purposes of the gift now and in the near future?

Finally, it is appropriate to pause and consider why, of the 30 states that enacted UMIFA, only Kansas and California omitted "and unrealized" from this provision. Two other states have enacted restrictions on the use of appreciation. Massachusetts law provides that:

> the appropriation of net appreciation for expenditure in any year in an amount greater than seven per cent of the fair market value of the institution's endowment funds, calculated on the basis of market values determined at least quarterly and averaged over a period of three or more years, shall create a rebuttable presumption of imprudence on the part of the governing board.

And Ohio law provides:

> The governing board of an institution may appropriate for expenditure for the uses and purposes for which an endowment

> fund is established up to fifth per cent of the net appreciation, realized and unrealized, in the fair value of the assets of an endowment fund over the historic dollar value of the fund, but only so much of such fifty per cent of the net appreciation as is prudent . . . .

We have received a letter from Jonathan A. Brown, on behalf of the Association of Independent California Colleges and Universities, responding to our inquiries on the unrealized appreciation issue. (See Exhibit 4, at exhibit pp. 30-32.) Mr. Brown supports the uniform language which permits use of both realized and unrealized appreciation, subject to a standard of prudence. He points out that the California rule has the effect of increasing transaction costs since appreciation has to be realized to be appropriated. He reports that the Association would support restoration of the uniform rule in draft Section 18502. This would give affected institutions needed flexibility in making investments and managing their assets. As to the concerns of the Attorney General's office, Mr. Brown writes:

> When we originally proposed the California version of UMIFA we proposed the language in the model statute. The representative of the Attorney General's Registry of Charitable Trusts demanded that we accept both provisions [the five year averaging rule and the restriction to "realized" appreciation]. Their basic reasoning was that the inclusion of unrealized appreciation would encourage charities to waste their assets. The five year calculation was also seen as a brake on potentially reckless behavior.
>
> In reality, the experience from the almost 30 states which have enacted a version of UMIFA suggests that the Ford Foundation's assumptions were closer to the mark. To my knowledge, there is virtually no evidence, in this state or others, that charities have used the new authority in an irresponsible manner. . . .
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> . . . The preliminary responses [of surveyed private colleges and universities] suggest that the Act has been quite useful to those institutions which have utilized it. The uniform response which I have gotten from our Chief Financial Officers about the Act can be summarized in two principles. First, the CFOs have used the Act responsibly. The Act has offered institutions an ability for what one CFO called greater "self sufficiency." The general evidence suggests that less sophisticated institutions have not utilized its provisions. Those that have have used it well. Among our institutions there are several financial officers who are investment managers who have received national recognition for their performance. The possibility that a

> charity would be spent into oblivion because it is allowed to use UMIFA is simply not demonstrated in the experience to date, either in California or in other states with broader statutes. Second, the two current restrictions in the Act have neither improved the safety of the Act or helped to achieve the original goals. Thus, we would be supportive [of] including unrealized appreciation and of modifying or eliminating the rolling average rule, within the proposed revision of the Act.

The staff agrees with the perspective stated by Mr. Brown. The governing boards of charitable institutions are entrusted by law and contract with the duty and authority to carry out the institution's charitable purposes and to fulfill the terms of endowments. No one else can be expected to perform this duty, and they should have the needed flexibility to discharge this duty effectively. The supervisory authority of the Attorney General is there to enforce the outside boundaries of fiduciary responsibility. The possibility that a useful and reasonable power can be abused does not justify refusing to permit use of that power by any institution. The authority is overwhelming for the proposition that the power to appropriate realized and unrealized appreciation in furtherance of eleemosynary institutions' purposes is useful and reasonable, perhaps even necessary. If the speculation, or even the probability, that some board may misapply this power or act imprudently were sufficient to stand in the way of this proposal, then it is a wonder that any fiduciary is permitted to exercise any power that could be abused. Any power *can* be abused by someone.

Respectfully submitted,

Stan G. Ulrich
Staff Counsel

EXHIBIT 1

UNIFORM MANAGEMENT OF INSTITUTIONAL FUNDS ACT

1972 Act

Table of Jurisdictions Wherein Act Has Been Adopted

Jurisdiction	Laws	Effective Date	Statutory Citation
California	1973, c. 950	9-30-1973	West's Ann.Cal.Civ.Code, §§ 2290.1 to 2290.12.
Colorado	1973, c. 126		C.R.S. 15-1-1101 to 15-1-1109.
Connecticut	1973, P.A. 73-548	7-1-1973 6-11-1973*	C.G.S.A. §§ 45-100h to 45-100p.
Delaware	1974, c. 572	7-29-1974	12 Del.C. §§ 4701 to 4708.
Dist. of Columbia	D.C.Laws No. 1-103	4-6-1977	D.C.Code 1981, §§ 32-401 to 32-409.
Georgia	1984, p. 831	3-28-1984	O.C.G.A. §§ 44-15-1 to 44-15-8.
Illinois	1973, P.A. 78-866	10-1-1973	S.H.A. ch. 32, ¶¶1101 to 1110.
Kansas	1973, c. 226	7-1-1973	K.S.A. 58-3601 to 58-3610.
Kentucky	1976, c. 115	6-19-1976	KRS 273.510 to 273.590.
Louisiana	1976, No. 410	7-31-1976*	LSA-R.S. 9:2337.1 to 9:2337.8.
Maryland	1973, c. 838	7-1-1973	Code, Estates and Trusts, §§ 15-401 to 15-409.
Massachusetts ...	1975, c. 886	1-17-1976*	M.G.L.A. c. 180A, §§ 1 to 11.
Michigan	1976, P.A. 157	6-17-1976	M.C.L.A. §§ 451.1201 to 451.1210.
Minnesota	1973, c. 313	8-1-1973*	M.S.A. §§ 309.62 to 309.71.
Montana	1973, c. 389	3-20-1973*	MCA 72-30-101 to 72-30-207.
New Hampshire ..	1973, c. 547:1	9-1-1973	RSA 292-B:1 to 292-B:9.
New Jersey	1975, c. 26	3-5-1975	N.J.S.A. 15:18-15 to 15:18-24.
New York	1978, c. 690	7-25-1978	McKinney's N-PCL, §§ 102, 512, 514, 522.
North Dakota	1975, c. 182	7-1-1975	NDCC 15-67-01 to 15-67-09.
Ohio	1975, p. 303	11-26-1975	R.C. §§ 1715.51 to 1715.59.
Oregon	1975, c. 707	9-13-1975	ORS 128.310 to 128.355.
Rhode Island	1972, c. 260	5-4-1972	Gen.Laws 1956, §§ 18-12-1 to 18-12-9.
Tennessee	1973, c. 177	5-7-1973	T.C.A. §§ 35-10-101 to 35-10-109.
Vermont	1973, No. 59	7-1-1973	14 V.S.A. §§ 3401 to 3407.
Virginia	1973, c. 167	3-10-1973*	Code 1950, §§ 55-268.1 to 55-268.10.
Washington	1973, c. 17	6-7-1973*	West's RCWA 24.44.010 to 24.44.900.
West Virginia	1979, c. 60	6-8-1979	Code, 44-6A-1 to 44-6A-8.
Wisconsin	1975, c. 247	5-15-1976	W.S.A. 112.10.

* Date of approval.

Historical Note

The Uniform Management of Institutional Funds Act was approved by the National Conference of Commissioners on Uniform State Laws in 1972.

PREFATORY NOTE

Over the past several years the governing boards of eleemosynary institutions, particularly colleges and universities, have sought to make more effective use of endowment and other investment funds. They and their counsel have wrestled with questions as to permissible investments, delegation of investment authority, and use of the total return concept in investing endowment funds. Studies of the legal authority and responsibility for the management of the funds of an institution have pointed up the uncertain state of the law in most jurisdictions. There is virtually no statutory law regarding trustees or governing boards of eleemosynary institutions, and case law is sparse. In the late 1960's the Ford Foundation commissioned Professor William L. Cary and Craig B. Bright, Esq., to examine the legal restrictions on the powers of trustees and managers of colleges and universities to invest endowment funds to achieve growth, to maintain purchasing power, and to expend a prudent portion of appreciation in endowment funds. They concluded that there was little developed law but that legal impediments which have been thought to deprive managers of their freedom of action appear on analysis to be more legendary than real. Cary and Bright, *The Law and The Lore of Endowment Funds*, 66 (1969).

Nonetheless it appears that counsel for some colleges and universities have advised to the contrary, basing such advice upon analogy to the law of private trusts. Not all counsel, of course, suggest that private trust laws control the governing boards of eleemosynary institutions.

There is, however, substantial concern about the potential liability of the managers of the institutional funds even though cases of actual liability are virtually nil. As deliberations of the Special Committee, the Advisory Committee and the Reporters responsible for the preparation of this Act have progressed, it became clear that the problems were not unique to educational institutions but were faced by any charitable, religious or any other eleemosynary institution which owned a fund to be invested.

One further problem regularly intruded upon the discussion of efforts to free trustees and managers from the alleged limitations on their powers to invest for growth and meet the financial needs of their institutions. Some gifts and grants contained restrictions on use of funds or selection of investments which imperiled the effective management of the fund. An expeditious means to modify obsolete restrictions seemed necessary.

The Uniform Act offers a rational solution to these problems by providing:

(1) a standard of prudent use of appreciation in invested funds;

(2) specific investment authority;

(3) authority to delegate investment decisions;

(4) a standard of business care and prudence to guide governing boards in the exercise of their duties under the Act; and

(5) a method of releasing restrictions on use of funds or selection of investments by donor acquiescence or court action.

Use of Appreciation

The argument for allowing prudent use of appreciation of endowment funds has been stated in Cary and Bright, *The Law and The Lore of Endowment Funds* 5–6 (1969):

> [T]oo often the desperate need of some institutions for funds to meet current operating expenses has led their managers, contrary to their best long-term judgment, to forego investments with favorable growth prospects if they have a low current yield.
>
> [I]t would be far wiser to take capital gains as well as dividends and interest into account in investing for the highest overall return consistent with the safety and preservation of the funds invested. If the current return is insufficient for the institution's needs, the difference between that return and what it would have been under a more restrictive policy can be made up by the use of a prudent portion of capital gains.

The Uniform Act authorizes expenditure of appreciation subject to a standard of business care and prudence. It seems unwise to fix more exact standards in a statute. To impose a greater construction would hamper adaptation by different institutions to their particular needs.

The standard of care is that of a reasonable and prudent director of a nonprofit corporation—similar to that of a director of a business corporation—which seems more appropriate than the traditional Prudent Man Rule applicable to private trustees. The approach has been used elsewhere. A New York statute allows inclusion in income of "so much of the realized appreciation as the board may deem prudent." New York [McKinney's] Not-for-Profit Corporation Law § 513(d) (1970). Recent enactments in New Jersey, California, and Rhode Island follow the same pattern. N.J.S.A. § 15:18–8; West's Anno. Corp.Code § 10251(c) (Calif.); Gen.Laws of R.I. § 18–2–2.

The Act authorizes the appropriation of net appreciation. "Realization" of gains and losses is an artificial, meaningless concept in the context of a nontaxable eleemosynary institution. If gains and losses had to be realized before being taken into account, a major objective of the Act, to avoid distortion of sound investment policies, would be frustrated. If only realized capital gains could be taken into account, trustees or managers might be forced to sell their best assets, appreciated property, in order to produce spendable gains and conceivably might spend realized gains even when, because of unrealized losses, the fund has no net appreciation.

The Act excludes interests held for private beneficiaries, even though a charity is the ultimate beneficiary, e.g., an individual life interest followed by a charitable remainder. Also excluded is any trust managed by a professional trustee even though a charitable organization is the sole beneficiary.

The Uniform Act has been drafted to meet the objection that there will be a decline in gifts to charity because donors cannot rely on their wishes being enforced if appreciation can be expended. The drafters were convinced that donors seldom give any indication of how they want the growth in their gifts to be treated. If, however, a donor does

indicate that he wishes to limit expenditures to ordinary yield, under the Act his wishes will be respected.

A statute such as this can be constitutionally applied to gifts received prior to its enactment. There is no substantial authority to be found in law or reason for denying retroactive application.

When the Uniform Principal and Income Act was adopted it changed the apportionment of some items of revenue between principal and income. It was argued that the retroactive application of the statute to existing trusts would deprive either the income beneficiaries or the remaindermen of their property without due process of law. Professor Scott spoke for the overwhelming majority of commentators when he said:

> [T]here should be no constitutional objection to making the Act retroactive. The rules as to allocation should not be treated as absolute rules of property law, but rather as rules as to the administration of the trust. The purpose is to make allocations which are fair and impartial as between the successive beneficiaries. Scott, Principal or Income?, 100 Trusts & Est. 180, 251 (1961).

Professor Bogert reached the same conclusion. Bogert, *The Law of Trusts and Trustees* § 847, pp. 505–6 (2d ed. 1962). The courts which considered the matter reached the same conclusion.

There is even less reason to deny retroactive application to an apportionment statute which deals only with the endowment funds of eleemosynary institutions, because the statute does not deprive any beneficiary of vested property rights. In a broad sense, the public is the real beneficiary of an endowment fund. The only argument which can be made against retroactivity is that it might violate the intent of the donor. Such an argument was also made in respect of the Uniform Principal and Income Act, but it was uniformly rejected by the courts. The language of a Minnesota case is typical:

> [I]t is doubtful whether testatrix had any clear intention in mind at the time the will was executed. It is equally plausible that if she had thought about it at all she would have desired to have the dividends to go where the law required them to go at the time they were received by the trustee. ... *In re Gardner's Trust*, 266 Minn. 127, 132, 123 N.W.2d 69, 73 (1963).

In any event, the Act does not raise a problem of retroactive application because the rule of construction of Section 3 is declaratory of existing law in that it interprets the presumed intent of the donor in the absence of a clear statement of the donor's intention.

Other similar acts follow the same pattern. The New York [McKinney's] Not-for-Profit Corporation Law Section 513(e) (1970) authorizing the expenditure of appreciation applies to assets "held at the time when this chapter takes effect" as well as to "assets hereafter received." Similar language appears in the New Jersey, California, and Rhode Island acts authorizing expenditure of appreciation by eleemosynary institutions.

Specific Investment Authority

It seems reasonably clear that investment managers of endowment funds are not limited to investments authorized to trustees. The broad

grant of investment authority contained in Section 4 of the Act expressly so provides.

Authority to Delegate

In the absence of clear law relating to the powers of governing boards of eleemosynary institutions, some boards have been advised that they are subject to the nondelegation strictures of professional private trustees. The board of an eleemosynary institution should be able to delegate day-to-day investment management to committees or employees and to purchase investment advisory or management services. The Act so provides.

Standard of Care

Fear of liability of a private trustee may have a debilitating effect upon members of a governing board, who are often uncompensated public-spirited citizens. They are managers of nonprofit corporations, guiding a unique and perhaps very large institution. The proper standard of responsibility is more analogous to that of a director of a business corporation than that of a professional private trustee. The Act establishes a standard of business care and prudence in the context of the operation of a nonprofit institution.

Release of Restrictions

It is established law that the donor may place restrictions on his largesse which the donee institution must honor. Too often, the restrictions on use or investment become outmoded or wasteful or unworkable. There is a need for review of obsolete restrictions and a way of modifying or adjusting them. The Act authorizes the governing board to obtain the acquiescence of the donor to a release of restrictions and, in the absence of the donor, to petition the appropriate court for relief in appropriate cases.

Conclusion

Over a decade ago, Professor Kenneth Karst in an article in the Harvard Law Review stated the need for the Uniform Act:

> [T]he managers of corporate charity are still, at this late date, without adequate guides for conduct. The development of these standards is of some urgency. The Efficiency of the Charitable Dollar: An Unfilled State Responsibility, 73 Harv.L.Rev. 433, 435 (1960).

General Statutory Notes

California. Adds sections as follows:

"§ 2290.10 Reports; contents

"Any institution electing to avail itself of the powers granted under this chapter shall periodically file with the Registrar of Charitable Trusts such report or reports as may reasonably be required by the Attorney General. Such reports shall be confidential and shall be limited to information relating

to the assets of the institution covered by this chapter and the results of the use of the powers granted by this chapter with respect to such assets. Any institution electing not to avail itself of the powers conferred by this chapter shall file a written statement to such effect with the registrar.

"This section shall remain in effect until January 1, 1983, and as of that date is repealed."

"§ 2290.11 Status of governing boards

"Nothing in this chapter shall be deemed to alter the status of governing boards under other chapters of this title, or other laws of the state."

Massachusetts. Adds sections as follows:

"§ 4. Accumulation of annual net income; reserve

"The governing board may accumulate so much of the annual net income of the institutional fund as is prudent under the standard established by section eight, and may hold any or all of such accumulated income in an income reserve for subsequent expenditure for the uses and purposes for which such institutional fund is established or may add any or all of such accumulated income to the principal of such institutional fund, as is prudent under said standard. This section does not limit the authority of the governing board to accumulate income or to add the same to principal of an institutional fund as permitted under other law, the terms of the applicable gift instrument, or the charter of the institution."

"§ 5. Restrictions in gift instruments against accumulation of income or addition to principal

"Section four does not apply if and to the extent that the applicable gift instrument indicates the donor's intention that income of an institutional fund shall not be accumulated or shall not be added to the principal of the fund. A restriction against accumulation or addition to principal may not be implied from a designation of a gift as an endowment fund, or from a direction or authorization in the applicable gift instrument to apply to the uses and purposes of the fund the 'income', 'interest', 'dividends', 'currently expendable income', or 'rent, issues or profits', or a direction which contains other words of similar import. This rule of construction applies to gift instruments executed or in effect before or after the effective date of this section."

Michigan. Adds a section as follows:

§ 451.1210 Construction of act not to prohibit investments or guaranteeing of obligations regardless of financial return or capital gain or loss

"This act shall not be construed to prevent an institution otherwise authorized by the terms of the applicable gift instrument establishing an endowment fund, or not prohibited by the terms of the applicable gift instrument establishing an institutional fund which is not an endowment fund, from making an investment or guaranteeing the obligations of others to further the educational, religious, charitable, or other eleemosynary purpose of the institution, regardless of whether any financial return is anticipated or any capital gain or loss is actually incurred."

New Hampshire. Adds sections as follows:

"292-B:1 Declaration of Purpose. It is hereby declared to be in the public interest and to be the policy of the state to promote, by all reasonable means, the maintenance and growth of eleemosynary institutions by encouraging them to establish and continue investment policies, without artificial constraints, which will provide them with the means to meet the present and future needs of such eleemosynary institutions pursuant to the provisions of this act. To this end it is hereby declared to be in the public interest and to be the policy of the state to encourage such institutions to adopt investment policies whose objective is to obtain the highest possible total rate of return consistent with the standard of prudence."

"292-B:3-a Accumulation of Annual Net Income; Reserve. The governing board may accumulate so much of the annual net income of an institutional fund as is prudent under the standard established by RSA 292-B:6, and may hold any or all of such accumulated income in an income reserve for subsequent expenditure for the uses and purposes for which such institutional fund is established or may add any or all of such accumulated income to the principal of such institutional fund, as is prudent under said standard. This section does not limit the authority of the governing board to accumulate income or to add the

same to principal of an institutional fund as permitted under other law, the terms of the applicable gift instrument, or the charter of the institution."

"292-B:3-b Restrictions in Gift Instruments. The provisions of RSA 292-B:3-a do not apply if and to the extent that the applicable gift instrument indicates the donor's intention that income of an institutional fund shall not be accumulated or shall not be added to the principal of the fund. A restriction against accumulation or addition to principal may not be implied from a designation of a gift as an endowment fund, or from a direction or authorization in the applicable gift instrument to apply to the uses and purposes of the fund the 'income', 'interest', 'dividends', 'currently expendable income', or 'rent, issues or profits', or a direction which contains other words of similar import. This rule of construction applies to gift instruments executed or in effect before or after the effective date of this section."

New York. The New York act is a substantial adoption of the major provisions of the Uniform Act, but contains numerous variations, omissions and additional matter which cannot be clearly indicated by statutory notes.

Rhode Island. The Rhode Island Act is a substantial adoption of the major provisions of the Uniform Act, but contains numerous variations, omissions and additional matter which cannot be clearly indicated by statutory notes.

UNIFORM MANAGEMENT OF INSTITUTIONAL FUNDS ACT

AN ACT to establish guidelines for the management and use of investments held by eleemosynary institutions and funds.

Section

Be it enacted .....

§ 1. [Definitions]

In this Act:

(1) "institution" means an incorporated or unincorporated organization organized and operated exclusively for educational, religious, charitable, or other eleemosynary purposes, or a governmental organization to the extent that it holds funds exclusively for any of these purposes;

(2) "institutional fund" means a fund held by an institution for its exclusive use, benefit, or purposes, but does not include (i) a fund held for an institution by a trustee that is not an institution or (ii) a fund in which a beneficiary that is not an institution has an interest, other than possible rights that could arise upon violation or failure of the purposes of the fund;

(3) "endowment fund" means an institutional fund, or any part thereof, not wholly expendable by the institution on a current basis under the terms of the applicable gift instrument;

(4) "governing board" means the body responsible for the management of an institution or of an institutional fund;

(5) "historic dollar value" means the aggregate fair value in dollars of (i) an endowment fund at the time it became an endowment fund, (ii) each subsequent donation to the fund at the time it is made, and (iii) each accumulation made pursuant to a direction in the applicable gift instrument at the time the accumulation is added to the fund. The determina-

tion of historic dollar value made in good faith by the institution is conclusive.

(6) "gift instrument" means a will, deed, grant, conveyance, agreement, memorandum, writing, or other governing document (including the terms of any institutional solicitations from which an institutional fund resulted) under which property is transferred to or held by an institution as an institutional fund.

COMMENT

The Uniform Act applies generally to colleges, universities, hospitals, religious organizations and other institutions of an eleemosynary nature. It applies to a governmental organization to the extent that the organization holds funds for the listed purposes, e.g., a public school which has an endowment fund.

[Subsec. (1)] A non-governmental institution which is not "charitable" in the classic sense is not within the Act, even though it may hold funds for such purpose. If the fund is separate and distinct from the noncharitable organization, the fund itself may be an institution, to which the Act applies.

[Subsec. (2)] An institutional fund is any fund held by an institution which it may invest for a long or short term. Excluded from the Act is any fund held by a trustee which is not an institution as defined in this Act, e.g., a bank or trust company, for the benefit of an institution even though the institution is the sole beneficiary.

A fund held by an institution for the benefit of any noninstitutional beneficiary is also excluded. The exclusion would apply to any fund with an individual beneficiary such as an annuity trust or a unitrust. When the interest of a noninstitutional beneficiary is terminated, the fund may then become an institutional fund.

The "use, benefit, or purposes" of an institution broadly encompasses all of the activities permitted by its charter or other source of authority. A fund to provide scholarships for students or medical care for indigent patients is held by the school or hospital for the institution's purposes. Such a fund is not deemed to be held for the benefit of a particular student or patient as distinct from the use, benefit, or purposes of the institution, nor does the student or patient have an interest in the fund as a "beneficiary which is not an institution."

The particular recipient of the aid of a charitable organization is not a "beneficiary" in the sense of a beneficiary of a private trust; only the Attorney General or similar public authority may enforce a charitable trust. 4 Scott, *Law of Trusts* § 348 pp. 2768–9 (3d ed. 1967); Bogert, *The Law of Trusts and Trustees* §§ 411–15 pp. 317–348 (2d ed. 1962).

[Subsec. (3)] An endowment fund is an institutional fund, or any part thereof, which is held in perpetuity or for a term and which is not wholly expendable by the institution. Implicit in the definition is the continued maintenance of all or a specified portion of the original gift. "Endowment fund" is specially defined because it is subject to the appropriation rules of Section 2.

A restriction on use that makes a fund an endowment fund arises only from the applicable gift instrument. If a governing board has the power to spend all of a fund but, in its discretion, decides to invest the fund and spend only the yield or appreciation therefrom, the fund does not become an endowment fund under this definition, but it may be described as a "quasi-endowment fund" or a "fund functioning as endowment."

A fund which is not an institutional fund originally and therefore not an endowment fund may become an endowment fund at a later time. For example, a fund given to an institution to pay the grantor's widow a life income, with the remainder to the institution, would become an institutional fund on the widow's death, and, if the fund were not then wholly expendable, it would become an endowment fund at that time.

If a gift instrument provided that the institution could use the income from the fund for ten years and thereafter spend the entire principal, the fund would be an endowment fund for the ten-year period and would cease to be an endowment fund at the time it became wholly expendable.

[Subsec. (4)] The definition is meant to designate the policy making or management group which has the responsibility for the affairs of the institution or the fund.

[Subsec. (5)] "Historic dollar value" is simply the value of the fund expressed in dollars at the time of the original contribution to the fund plus the dollar value of any subsequent gifts to the fund. Accounting entries recording realization of gains or losses to the fund have no effect upon historic dollar value. No increase or decrease in historic dollar value of the fund results from the sale of an asset held by the fund and the reinvestment of the proceeds in another asset.

If the gift instrument directs accumulation, the historic dollar value will increase with each accumulation. For example, if a donor gives an institution $300,000 and directs that the fund is to be accumulated until its value reaches $500,000, the historic dollar value will be the aggregate value of $500,000 at the time the fund becomes available for use by the institution.

If under the terms of the gift instrument a portion of an endowment fund, after passage of time or upon the happening of some event, becomes currently wholly expendable, such portion should be treated as a separate fund and the historic dollar value of the remaining endowment fund should be reduced proportionately.

[Subsec. (6)] A gift instrument establishes the terms of the gift. It may be a writing of any form, or it may result from the institution's solicitation activities, or the by-laws, or other rules of an existing fund.

Action in Adopting Jurisdictions

Variations from Official Text:

California. In subsec. (1), defines "Institution" as "a private incorporated or unincorporated organization organized and operated exclusively for educational purposes and accredited by the Association of Western Colleges and Universities to the extent that it holds funds exclusively for any of such purposes".

Subsec. (5) reads: " 'Historic dollar value' means the aggregate fair value in dollars of (i) an endowment fund at the time it became an endowment fund, (ii) each subsequent donation to the fund at the time it is made, and (iii) each accumulation made pursuant to a direction in the applicable gift instrument at the time the accumulation is added to the fund."

Colorado. In subsec. (4), omits "of an institution or".

In subsec. (6), omits "writing".

Connecticut. In subsec. (1), includes a charitable community trust as described in section 45–81 within the definition of institution.

In subsec. (2), inserts "other than a fund which is held for a charitable community trust" following "not an institution" in clause (i).

Subsec. (5) reads:

" 'Historic dollar value' means the aggregate fair value in dollars of

"(A) an endowment fund at the time it became an endowment fund,

"(B) each subsequent donation to the fund at the time it is made, and

"(C) each accumulation made pursuant to a direction in the applicable gift instrument

at the time the accumulation is added to the fund.

"The determination of historic dollar value made in good faith by the institution is conclusive."

Georgia. Omits subsec. (5).

Kansas. Subsec. (5) reads: "(5) 'historic dollar value' means the fair value in dollars of an endowment fund at the time it first became an endowment fund, plus the fair value in dollars of each subsequent donation to the fund at the time it is made, plus the fair value in dollars of each accumulation made pursuant to a direction in the applicable gift instrument at the time the accumulation is added to the fund. The determination of historic dollar value made in good faith by the institution is conclusive;"

Louisiana. In subsec. (6), inserts "donation," following "grant,".

Minnesota. Omits subsec. (4).

Subsec. (5) reads: " 'Historic dollar value' means the aggregate fair value in dollars of (a) an endowment fund at the time it became an endowment fund, (b) each subsequent donation to the fund at the time it is made, and (c) each accumulation made pursuant to a direction in the applicable gift instrument at the time the accumulation is added to the fund. The determination of historic dollar value made in good faith by the institution is conclusive."

Montana. Subsec. (5) reads:

" 'Historic dollar value' means the aggregate fair value in dollars of

"(a) an endowment fund at the time it became an endowment fund,

"(b) each subsequent donation to the fund at the time it is made, and

"(c) each accumulation made pursuant to a direction in the applicable gift instrument at the time the accumulation is added to the fund.

"The determination of historic dollar value made in good faith by the institution is conclusive."

New Jersey. In subsec. (1), inserts "hospital" following "charitable,".

North Dakota. In subsec. (2), includes a perpetual trust fund established by section 153 of the Constitution of the state of North Dakota within the definition of "institutional fund".

Ohio. In subsec. (1), substitutes "or religious" for ", religious, charitable, or other eleemosynary" and "either" for "any", and adds sentence as follows: "Such definitions do not apply to Section 109.23 of the Revised Code."

In subsec. (2), clause (ii), omits ", other than possible rights that could arise upon violation or failure of the purposes of the fund".

Oregon. In subsec. (1), defines "institution" as "an incorporated or unincorporated nonpublic organization organized and operated exclusively for educational, religious, charitable, or other eleemosynary purposes."

Tennessee. Introductory text reads: "As used in this chapter, unless the context otherwise requires:".

Vermont. In subsec. (5), makes some minor language changes without affecting substance.

Law Review Commentaries

Liability of directors and officers of not-for-profit corporations. Bennet B. Harvey, Jr. 17 John Marshall L.Rev. 665 (1984).

Library References

Charities ⇐48(1).
Colleges and Universities ⇐6(5).

C.J.S. Charities § 47.
C.J.S. Colleges and Universities § 14.

Notes of Decisions

1. Jurisdiction

The probate court is a "court of competent jurisdiction" to resolve questions of the management of a trust or charitable fund arising under the Uniform Management of Institutional Funds Law. Williams College v. Attorney General, 1978, 375 N.E.2d 1225, 375 Mass. 220.

2. Venue

Probate court in county in which college has its usual place of business is an appropriate forum for granting college equitable relief under the Uniform Management of Institutional Funds Law, even though fund derives from instrument made in another county or state. Williams College v. Attorney General, 1978, 375 N.E.2d 1225, 375 Mass. 220.

The Berkshire County Probate Court was a proper forum for action to resolve questions of the management of charitable funds arising under the Uniform Management of Institutional Funds Law, although the trusts, and donors were strangers to the Probate Court in the sense that the trust institution, in its formation and operation, and the gifts to it, were all without the judicial aegis of the Berkshire County Probate Court, where the college to which funds were donated was located within Berkshire County, no other court had assumed jurisdiction as to inter vivos gifts, and probate in another county of estates of testamentary donors had terminated. Id.

§ 2. [Appropriation of Appreciation]

The governing board may appropriate for expenditure for the uses and purposes for which an endowment fund is established so much of the net appreciation, realized and unrealized, in the fair value of the assets of an endowment fund over the historic dollar value of the fund as is prudent under the standard established by Section 6. This Section does not limit the authority of the governing board to expend funds as permitted under other law, the terms of the applicable gift instrument, or the charter of the institution.

COMMENT

This section authorizes a governing board to expend for the purposes of the fund the increase in value of an endowment fund over the fund's historic dollar value, within the limitations of Section 6 which establishes a standard of business care and prudence.

The section does not apply to funds which are wholly expendable by the institution such as so-called "quasi-endowment funds" or "funds functioning as endowment," nor does the section limit or reduce any spending power granted by a gift instrument or otherwise held by the institution.

Unrealized gains and losses must be combined with realized gains and losses to insure that the historic dollar value is not impaired.

Action in Adopting Jurisdictions

Variations from Official Text:

California. Omits "and unrealized", and adds sentence which reads: "Appropriations shall be based upon an average fair value covering a period of up to the five preceding fiscal years of the institution and shall be set at any reasonable date prior to each fiscal year."

Delaware. Make some language changes without affecting substance.

Georgia. Section reads: "The governing board may accumulate so much of the annual net income of an institutional fund as is prudent under the standard established by Code Section 44–15–7 [section 6 of the Uniform Act] and may hold any or all of such accumulated income in an income reserve for subsequent expenditure for the uses and purposes for which such institutional fund is established or may add any or all of such accumulated income to the principal of such institutional fund, as is prudent under said standard. This Code section does not limit the authority of the governing board to accumulate income or to add the same to principal of an institutional fund as permitted under other law, the terms of the applicable gift instrument, or the charter of the institution."

Kansas. Omits "and unrealized".

Massachusetts. Adds the following at the end of the first sentence: "provided, however, the appropriation of net appreciation for expenditure in any year in an amount greater than seven per cent of the fair market value of the institution's endowment funds, calculated on the basis of market values determined at least quarterly and averaged over a period of three or more years, shall create a rebuttable presumption of imprudence on the part of the governing board."

Ohio. Section reads: "The governing board of an institution may appropriate for expenditure for the uses and purposes for which an endowment fund is established up to fifty per cent of the net appreciation, realized and unrealized, in the fair value of the assets of an endowment fund over the historic dollar value of the fund, but only so much of such fifty per cent of the net appreciation as is prudent under the standard established by section 1715.56 of the Revised Code. This section does not limit the authority of the governing board to expend funds as permitted under other law, the terms of the applicable gift instrument, or the charter of the institution."

Library References

Charities ⇐48(1).
Colleges and Universities ⇐6(5).

C.J.S. Charities § 47.
C.J.S. Colleges and Universities § 14.

§ 3. [Rule of Construction]

Section 2 does not apply if the applicable gift instrument indicates the donor's intention that net appreciation shall not be expended. A restriction upon the expenditure of net appreciation may not be implied from a designation of a gift as an endowment, or from a direction or authorization in the applicable gift instrument to use only "income," "interest," "dividends," or "rents, issues or profits," or "to preserve the principal intact," or a direction which contains other words of similar import. This rule of construction applies to gift instruments executed or in effect before or after the effective date of this Act.

COMMENT

If a gift instrument expresses or otherwise indicates the donor's intention that the governing board may not appropriate the appreciation in the value of the fund, his wishes will govern.

The rule of construction of this section is based upon the assumption that a grantor who makes an outright gift to an educational, religious, charitable or other eleemosynary institution seldom makes a full statement of his intentions and that his unstated intention is usually quite different from the intention of a grantor who makes a gift to a trust for private beneficiaries. The assumption is that the grantor of a gift to an institution: (1) means to devote to the institution any return or

benefit that the institution can obtain from the gift, (2) acknowledges the responsibility of the institutional management to determine the prudent use of the return or benefit over time and (3) usually regards the "amount" of the gift as the dollars given or the dollar value of the property transferred to the institution at the time of the gift. Thus, in the case of a gift instrument which states no clear intention or merely echoes the rubrics of a private trust, the statutory rule of interpretation should apply.

Some advisers to institutions, aware of the body of private trust law, have interpreted references to "income" or "principal" in a gift instrument to evidence a grantor's intent that the private trust rules developed to insure equity between an income beneficiary and a remainderman should be applied to an outright gift to an institutional donee. Neither the facts of donor's intentions nor the law of trusts support such an interpretation of the meaning of gift instruments where an institution is the sole beneficiary.

This section does not purport to change existing law or rights; it simply codifies a rule of construction or interpretation or administration by articulating the presumed intent of a donor in the absence of a statement of the donor's actual intent.

Action in Adopting Jurisdictions

Variations from Official Text:

California. Section reads:

"(a) Section 2290.2 does not apply if the applicable gift instrument indicates the donor's intention that net appreciation shall not be expended.

"(b) With respect to gift instruments in effect prior to the effective date of this section, a restriction upon the expenditure of net appreciation need not be implied solely from a designation of a gift as an endowment, or from a direction or authorization in the applicable gift instrument to use only 'income,' 'dividends,' or 'rents, issues or profits,' or 'to preserve the principal intact,' or a direction which contains other words of similar import.

"(c) With respect to gift instruments executed or becoming effective after the effective date of this section, a restriction upon the expenditure of net appreciation may not be implied from a designation of a gift as an endowment or from a direction or authorization in the applicable gift instrument to use only 'income,' 'interest,' 'dividends,' or 'rents, issues or profits,' or 'to preserve the principal intact,' or a direction which contains other words of similar import."

Colorado. Substitutes "all gift instruments whenever executed" for "gift instruments executed or in effect before or after the effective date of this act".

Georgia. Section reads: "Code Section 44-15-3 [section 2 of the Uniform Act] does not apply if and to the extent that the applicable gift instrument indicates the donor's intention that income of an institutional fund shall not be accumulated or shall not be added to the principal of the fund. A restriction against accumulation or addition to principal may not be implied from a designation of a gift as an endowment fund or from a direction or authorization in the applicable gift instrument to apply to the uses and purposes of the fund the 'income,' 'interest,' 'dividends,' 'currently expendable income,' or 'rent, issues, or profits' or a direction which contains other words of similar import. This rule of construction applies to gift instruments executed or in effect before or after the effective date of this chapter."

Louisiana. Inserts " 'usufruct,' " following " 'dividends,' " and "or 'to preserve the naked ownership intact,' " following " 'to preserve the principle intact,' ".

Ohio. Section reads: "Section 1715.52 of the Revised Code does not apply if the applicable gift instrument indicates the donor's intention that net appreciation shall not be expended."

Washington. Omits this section.

Library References

Charities ⇐48(1).
Colleges and Universities ⇐6(5).

C.J.S. Charities § 47.
C.J.S. Colleges and Universities § 14.

§ 4. [Investment Authority]

In addition to an investment otherwise authorized by law or by the applicable gift instrument, and without restriction to investments a fiduciary may make, the governing board, subject to any specific limitations set forth in the applicable gift instrument or in the applicable law other than law relating to investments by a fiduciary, may:

(1) invest and reinvest an institutional fund in any real or personal property deemed advisable by the governing board, whether or not it produces a current return, including mortgages, stocks, bonds, debentures, and other securities of profit or nonprofit corporations, shares in or obligations of associations, partnerships, or individuals, and obligations of any government or subdivision or instrumentality thereof;

(2) retain property contributed by a donor to an institutional fund for as long as the governing board deems advisable;

(3) include all or any part of an institutional fund in any pooled or common fund maintained by the institution; and

(4) invest all or any part of an institutional fund in any other pooled or common fund available for investment, including shares or interests in regulated investment companies, mutual funds, common trust funds, investment partnerships, real estate investment trusts, or similar organizations in which funds are commingled and investment determinations are made by persons other than the governing board.

COMMENT

Institutional investment managers suggest that a general grant of investment powers will clarify the authority of a governing board to select investments. Subsection (1) provides broad powers of investment and states that a governing board is not restricted to investments authorized to trustees.

Two other matters of investment policy have been troublesome to boards because of the absence of specific authority. Subsections (2) and (3) provide authority to hold property given by a donor even though it may not be the best investment (ordinarily in the hope of obtaining additional contributions) and to invest in common or pooled investment funds such as the Common Fund for Non-Profit Organizations. See 4 Scott, *Law of Trusts*, § 389 pp. 2997–3000 (3d ed. 1967).

The absence of specific reference to investment for return by an institution in its own facilities does not limit the power of a governing board to make such investments under the general clause of Section 4(1), or other law or the gift instrument.

Section 6 establishes the standard of care and prudence under which the investment authority is exercised.

Action in Adopting Jurisdictions

Variations from Official Text:

California. Introductory clause reads: "In addition to an investment otherwise authorized by law or by the applicable gift instrument, the governing board, subject to any specific limitations set forth in the applicable gift instrument, may do any or all of the following:"

In subsec. (1), inserts "or individuals", following "partnerships."

Colorado. In introductory clause, substitutes "is authorized to make" for "may make" and "a fiduciary is authorized to make" for "by a fiduciary".

In subsec. (1), omits "debentures".

Georgia. In introductory clause, substitutes "any" for "an".

Kansas. In introductory clause, substitutes "is authorized to make" for "may make" and "a fiduciary is authorized to make" for "by a fiduciary".

Louisiana. In subsec. (1), substitutes "corporeal or incorporeal immovable or movable" for "real or personal".

New Hampshire. Subsec. (3) reads: "Include all or any part of an institutional fund or all or any part of a pooled income fund (as defined in Section 642(c)(5) of the Internal Revenue Code of 1954 as amended ('the Code')), as charitable remainder annuity trust (as defined in Section 664(d)(1) of the Code), or a charitable remainder unitrust (as defined in Section 664(d)(2) of the Code) in one or more pooled or common funds maintained by the institution; and"

In subsec. (4), inserts "pooled income fund, charitable remainder annuity trust or charitable remainder unitrust" following "part of an institutional fund".

Ohio. In introductory clause, inserts "of an institution" following "governing board".

In subsec. (4), adds sentence as follows: "All institutional funds held by a governmental organization shall be audited by the auditor of state."

Library References

Charities ⇐48(1).
Colleges and Universities ⇐6(5).

C.J.S. Charities § 47.
C.J.S. Colleges and Universities § 14.

§ 5. [Delegation of Investment Management]

Except as otherwise provided by the applicable gift instrument or by applicable law relating to governmental institutions or funds, the governing board may (1) delegate to its committees, officers or employees of the institution or the fund, or agents, including investment counsel, the authority to act in place of the board in investment and reinvestment of institutional funds, (2) contract with independent investment advisors, investment counsel or managers, banks, or trust companies, so to act, and (3) authorize the payment of compensation for investment advisory or management services.

COMMENT

Questions have arisen about the power of a governing board to delegate investment decisions. In the absence of authority, some boards have tried to follow the nondelegation principles applicable to trustees. Governing boards do, in fact, delegate investment authority, sometimes with rather cumbersome procedures to produce a record of apparent decisions by the boards.

This section clarifies the authority to delegate investment management and to purchase investment advisory and

management services. Responsibility for investment policy and selection of competent agents remains with the board under the Section 6 standard of business care and prudence.

Action in Adopting Jurisdictions

Variations from Official Text:

Michigan. In clause (2), substitutes "to act in place of the board in investment and reinvestment of institutional funds" for ", so to act,".

Ohio. Inserts "of an institution" following "governing board".

Oregon. Omits exception clause.

Law Review Commentaries

Liability of directors and officers of not-for-profit corporations. Bennet B. Harvey, Jr. 17 John Marshall L.Rev. 665 (1984).

Library References

Charities ⇐48(1).
Colleges and Universities ⇐6(5).

C.J.S. Charities § 47.
C.J.S. Colleges and Universities § 14.

§ 6. [Standard of Conduct]

In the administration of the powers to appropriate appreciation, to make and retain investments, and to delegate investment management of institutional funds, members of a governing board shall exercise ordinary business care and prudence under the facts and circumstances prevailing at the time of the action or decision. In so doing they shall consider long and short term needs of the institution in carrying out its educational, religious, charitable, or other eleemosynary purposes, its present and anticipated financial requirements, expected total return on its investments, price level trends, and general economic conditions.

COMMENT

The section establishes a standard of care and prudence for a member of a governing board. The standard is generally comparable to that of a director of a business corporation rather than that of a private trustee, but it is cast in terms of the duties and responsibilities of a manager of a nonprofit institution.

Officers of a corporation owe a duty of care and loyalty to the corporation, and the more intimate the knowledge of the affairs of the corporation the higher the standard of care. Directors are obligated to act in the utmost good faith and to exercise ordinary business care and prudence in all matters affecting the management of the corporation. This is a proper standard for the managers of a nonprofit institution, whether or not it is incorporated.

The standard of Section 6 was derived in part from Proposed Treasury Regulations § 53.4944-1(a)(2) dealing with the investment responsibility of managers of private foundations.

The standard requires a member of a governing board to weigh the needs of today against those of the future.

Action in Adopting Jurisdictions

Variations from Official Text:

California. Section reads: "In investing, reinvesting, purchasing, acquiring, exchanging, selling and managing property, appropriating appreciation and delegating investment management for the benefit of an institution, the members of the governing board shall exercise the judgment, care and prudence, under the circumstances then prevailing, which men of discretion and intelligence exercise in the management of their affairs. In exercising judgment under this section, the members of the governing board shall consider the long and short term needs of the institution in carrying out its purposes, its present and anticipated financial requirements, expected total return on its investments, general economic conditions, the appropriateness of a reasonable proportion of higher risk investment with respect to institutional funds as a whole, income, growth, and long term net appreciation, as well as the probable safety of funds."

Colorado. Omits "business" preceding "care and prudence".

Georgia. Substitutes "accumulate income" for "appropriate appreciation".

Massachusetts. Section reads:

"In the administration of the powers to appropriate appreciation, to accumulate income, to make and retain investments, and to delegate investment management of institutional funds, members of a governing board shall consider long and short term needs of the institution in carrying out its educational, religious, charitable or other eleemosynary purposes, the problems peculiar to the institution, its present and anticipated financial requirements, expected total return on its investments, price level trends, and general economic conditions.

"No member of the governing board shall be liable for any action taken or omitted with respect to such appropriation or accumulation or with respect to the investment of institutional funds, including endowment funds, under the authority granted in this chapter, if such member shall have discharged the duties of his position in good faith and with that degree of diligence, care and skill which prudent men would ordinarily exercise under similar circumstances in a like position."

Michigan. Section reads:

"(1) In the administration of the powers to appropriate appreciation, to make and retain investments, and to delegate investment management of institutional funds, members of a governing board shall exercise ordinary business care and prudence under the facts and circumstances prevailing at the time of the action or decision. Persons to whom the governing board has delegated authority, or with whom the governing board has contracted, to act in its place in investment and reinvestment of institutional funds shall exercise ordinary business care and prudence under the facts and circumstances prevailing at the time of the action or decision.

"(2) In exercising ordinary business care and prudence pursuant to subsection (1), the governing board or person to whom investment or reinvestment authority is delegated or with whom such authority is contracted shall consider the long- and short-term needs of the institution in carrying out its educational, religious, charitable, or other eleemosynary purposes, its present and anticipated financial requirements, expected total return on its investments, price level trends, and general economic conditions."

New Hampshire. Inserts "to accumulate income or add income to principal," following "appropriate appreciation" in first sentence, and adds the following at end of section: "Provided, however, the appropriation of appreciation in any years in an amount greater than seven percent of the fair market value of the assets of the institution's endowment funds (calculated on the basis of market values determined at least quarterly and averaged over a period of three or more years) shall create a rebuttable presumption of imprudence on the part of the governing board."

Ohio. Inserts "of an institution" following "governing board" and substitutes "or religious" for ", religious, charitable, or other eleemosynary".

Law Review Commentaries

Liability of directors and officers of not-for-profit corporations. Bennet B. Harvey, Jr. 17 John Marshall L.Rev. 665 (1984).

Library References

Charities ⇐48(1).
Colleges and Universities ⇐6(5).

C.J.S. Charities § 47.
C.J.S. Colleges and Universities § 14.

Notes of Decisions

1. Diversification of investments

Trustee is under a duty to beneficiary to distribute risk of loss by reasonable diversification of investments unless under circumstances it is prudent not to do so. Matter of Estate of Collins, 1977 139 Cal.Rptr. 644, 72 C.A.3d 663.

§ 7. [Release of Restrictions on Use or Investment]

(a) With the written consent of the donor, the governing board may release, in whole or in part, a restriction imposed by the applicable gift instrument on the use or investment of an institutional fund.

(b) If written consent of the donor cannot be obtained by reason of his death, disability, unavailability, or impossibility of identification, the governing board may apply in the name of the institution to the [appropriate] court for release of a restriction imposed by the applicable gift instrument on the use or investment of an institutional fund. The [Attorney General] shall be notified of the application and shall be given an opportunity to be heard. If the court finds that the restriction is obsolete, inappropriate, or impracticable, it may by order release the restriction in whole or in part. A release under this subsection may not change an endowment fund to a fund that is not an endowment fund.

(c) A release under this section may not allow a fund to be used for purposes other than the educational, religious, charitable, or other eleemosynary purposes of the institution affected.

(d) This section does not limit the application of the doctrine of *cy pres*.

COMMENT

One of the difficult problems of fund management involves gifts restricted to uses which cannot be feasibly administered or to investments which are no longer available or productive. There should be 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. See *Restatement of Trusts* (2d), §§ 381, 399; 4 Scott, *Law of Trusts* § 399, p. 3084, § 399.4 pp. 3119 et seq. (3d ed. 1967).

This section permits a release of limitations that imperil efficient administration of a fund or prevent sound investment management if the governing board can secure the approval of the donor or the appropriate court.

Although the donor has no property interest in a fund after the gift, nonetheless if it is the donor's limitation

that controls the governing board and he or she agrees that the restriction need not apply, the board should be free of the burden. See *Restatement of Trusts* (2d) § 367. Scott suggests that in minor matters, the consent of the settlor may be effective to remove restrictions upon the trustees in the administration of a charitable trust. 4 Scott, § 367.3 p. 2846 (3d ed. 1967).

If the donor is unable to consent or cannot be identified, the appropriate court may upon application of a governing board release a limitation which is shown to be obsolete, inappropriate or impracticable.

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*. A liberalization of addition to, or substitute for *cy pres* is not without respectable support. Professor Kenneth Karst in "The Efficiency of the Charitable Dollar: An Unfilled State Responsibility," 73 *Harv.L.Rev.* 433 (1960) suggested that the doctrine of *cy pres* be expanded to permit the courts to redirect charitable grants if the purpose had become "obsolete, or useless, or prejudicial to the public welfare, or are insignificant in comparison with the magnitude of the endowment . . ." quoting from the Nathan Report (of the British Committee on the Law and Practice Relating to Charitable Trusts, Cmd. 8710, 1952) quoting the Scotland Education Act 1946, 9–10 Geo. 6, ch. 72 § 119(b). The Uniform Act provision is far less broad; it applies only to the release of restrictions on the gift under limited circumstances.

New England courts apply a rather strict doctrine of separation of powers to deny legislative encroachment on judicial *cy pres*. The Act is compatible with the New England cases because the final decision is in the courts. See *City of Hartford v. Larrabee Fund Association*, 161 Conn. 312, 288 A.2d 71 (1971); Opinion of Justices, 101 N.H. 531, 133 A.2d 792 (1957).

No federal tax problems for the donor are anticipated by permitting release of a restriction. The donor has no right to enforce the restriction, no interest in the fund and no power to change the eleemosynary beneficiary of the fund. He may only acquiesce in a lessening of a restriction already in effect.

Action in Adopting Jurisdictions

Variations from Official Text:

California. Section reads:

"(a) With the written consent of the donor, the governing board may release, in whole or in part, a restriction imposed by the applicable gift instrument on the use or investment of an institutional fund.

"(b) If written consent of the donor cannot be obtained by reason of his death, disability, unavailability, or impossibility of identification, the governing board may apply in the name of the institution to the superior court of the county in which the principal activities of the institution are conducted, or other court of competent jurisdiction for release of a restriction imposed by the applicable gift instrument on the use or investment of an institutional fund. No court shall have jurisdiction to modify any use of an institutional fund under this chapter unless the Attorney General is a party to the proceedings. If the court finds that the restriction is obsolete, or impracticable, it may by order release the restriction in whole or in part. A release under this subdivision may not change an endowment fund to a fund that is not an endowment fund.

"(c) A release under this section may not allow a fund to be used for purposes other than the educational, religious, charitable, or other eleemosynary purposes of the institution affected.

"(d) This section does not limit the application of the doctrine of cy pres."

Colorado. Section reads:

"(1) A restriction on the use of an institutional fund imposed by the applicable gift instrument may be released, entirely or in part, by the governing board with the written consent of the donor.

"(2) If consent of the donor cannot be obtained by reason of death, disability, unavailability, or impossibility of identification of the donor, upon application of the governing board, a restriction on the use or investment of an institutional fund imposed by the applicable gift instrument may be released, entirely or in part, by order of the district court after reasonable notice to the attorney general and an opportunity for him to be heard, and upon a finding that the restriction on the use or investment of the fund is obsolete, inappropriate, or impracticable. A release under this subsection (2) may not change an endowment fund to a fund which is not an endowment fund.

"(3) A release under this section may not allow a fund to be used for purposes other than educational, religious, or other eleemosynary purposes of the institution affected.

"(4) The provisions of this section do not limit the application of the doctrine of cy pres."

Connecticut. Subsec. (b) reads: "If written consent of the donor cannot be obtained by reason of his death, disability, unavailability or impossibility of identification, the governing board may apply, in the name of the institution, to the superior court for a county or judicial district in which the institution conducts its affairs for release of a restriction imposed by the applicable gift instrument on the use or investment of an institutional fund. The attorney general shall be notified of the application and shall be given an opportunity to be heard. If the court finds that the restriction is obsolete, inappropriate or impracticable, it may by order release the restriction in whole or in part. A release under this subsection may not change an endowment fund to a fund that is not an endowment fund."

In subsec. (d), adds "or approximation" following "cy pres."

District of Columbia. In subsec. (b), provides that the Corporation Counsel of the District of Columbia shall be notified of the application and shall be given an opportunity to be heard and further that the Attorney General of the United States shall be notified of the application and shall be given an opportunity to be heard when a Federal interest in the application or the institution is asserted.

Georgia. Omits this section.

Illinois. Omits subsec. (b).

Kansas. Subsec. (a) reads: "(*a*) A restriction on the use or investment of an institutional fund imposed by the applicable gift instrument may be released, entirely or in part, by the governing board with the written consent of the donor."

Subsec. (b) reads: "(*b*) If consent of the donor cannot be obtained by reason of the death, disability or unavailability, or impossibility of identification of the donor, upon application of the governing board, a restriction on the use or investment of an institutional fund imposed by the applicable gift instrument may be released, entirely or in part, by order of the district court after reasonable notice to the attorney general and an opportunity for him to be heard, and upon a finding that the restriction on the use or investment of the fund is obsolete, inappropriate or impracticable. A release under this subsection may not change an endowment fund to a fund which is not an endowment fund."

Louisiana. In subsec. (b), inserts "by petition" following "may apply" and substitutes the following for the second sentence: "The [Attorney General]", the following: "Notification of interested parties shall be made in accordance with R.S. 9:2332."

Michigan. In subsec. (b), inserts "or legal incapacity" following "disability".

In subsec. (c), substitutes "shall" for "may".

Minnesota. Subsec. (b) reads: "If written consent of the donor cannot be obtained by reason of his death, disability, unavailability, or impossibility of identification, the governing board may apply in the name of the institution to the district court for release of a restriction imposed by the applicable gift instrument on the use or investment of an institutional fund. The attorney

general shall be notified of the application and shall be given an opportunity to be heard. If the court finds that the restriction is obsolete, inappropriate, or impracticable, it may by order release the restriction in whole or in part. A release under this subsection may not change an endowment fund to a fund that is not an endowment fund."

Montana. Section reads:

"(1) With the written consent of the donor, the governing board may release, in whole or in part, a restriction imposed by the applicable gift instrument on the use or investment of an institutional fund.

"(2) If written consent of the donor cannot be obtained by reason of his death, disability, unavailability or impossibility of identification, the governing board may apply in the name of the institution to the appropriate court for release of a restriction imposed by the applicable gift instrument on the use or investment of an institutional fund. The attorney general shall be notified of the application and shall be given an opportunity to be heard. If the court finds that the restriction is obsolete, inappropriate or impracticable, it may by order release the restriction in whole or in part. A release under this subsection may not change an endowment fund to a fund that is not an endowment fund.

"(3) A release under this section may not allow a fund to be used for purposes other than the educational, religious, charitable or other eleemosynary purposes of the institution affected.

"(4) This section does not limit the application of the doctrine of cy pres."

New Hampshire. In subsec. (d), adds "or deviation of trust" at the end thereof.

Ohio. In subsec. (a), inserts "of an institution" following "governing board".

Subsec. (b) reads: "If written consent of the donor cannot be obtained by reason of his death, disability, unavailability, or impossibility of identification, the governing board may apply in the name of the institution to the appropriate court for release of a restriction imposed by the applicable gift instrument on the use or investment of an institutional fund, the attorney general is a necessary party to and shall be served with process in all such proceedings. A judgment rendered in such proceedings without service of process upon the attorney general is void. If the court finds that the restriction is obsolete or impossible, it may by order release the restriction in whole or in part. A release under this division may not change an endowment fund to a fund that is not an endowment fund."

In subsec. (c), substitutes "or religious" for ", religious, charitable, or other eleemosynary".

Vermont. Subsec. (a) reads: "With the written consent of the donor, the governing board may release, in whole or in part, a restriction imposed by the applicable gift instrument on the use or investment of an institutional fund."

Subsec. (b) reads: "If written consent of the donor cannot be obtained by reason of his death, disability, unavailability, or impossibility of identification, the governing board may apply in the name of the institution to the county court for release of a restriction imposed by the applicable gift instrument on the use or investment of an institutional fund. The attorney general shall be notified of the application and shall be given an opportunity to be heard. If the court finds that the restriction is obsolete, inappropriate or impracticable, it may by order release the restriction in whole or in part. A release under this subsection may not change an endowment fund to a fund that is not an endowment fund."

Library References

Charities ⇐37(1), 48(1).
Colleges and Universities ⇐6(5).

C.J.S. Charities §§ 47, 50 et seq.
C.J.S. Colleges and Universities § 14.

Notes of Decisions

1. Generally

The Berkshire County Probate Court was a proper forum to resolve the issues presented in proceeding seeking release of restrictions on investment of testamentary gifts to college located in Berkshire County, where the estates were probated within Massachusetts but outside Berkshire County. Williams College v. Attorney General, 1978, 375 N.E.2d 1225, 375 Mass. 220.

Although the legislature may put certain conditions on money that it appropriates for the Michigan State University, and such conditions are binding if the trustees accept the money, the conditions may not interfere with the trustees' management of the University and may be applied only to state appropriated funds. William C. Reichenbach Co. v. State, 1979, 288 N.W.2d 622, 94 Mich.App. 323.

§ 8. [Severability]

If any provision of this Act or the application thereof to any person or circumstances is held invalid, the invalidity shall not affect other provisions or applications of the Act which can be given effect without the invalid provision or application, and to this end the provisions of this Act are declared severable.

Library References

Statutes ⇐64(2).
C.J.S. Statutes § 96 et seq.

§ 9. [Uniformity of Application and Construction]

This Act shall be so applied and construed as to effectuate its general purpose to make uniform the law with respect to the subject of this Act among those states which enact it.

Library References

Statutes ⇐226.
C.J.S. Statutes § 371 et seq.

§ 10. [Short Title]

This Act may be cited as the "Uniform Management of Institutional Funds Act."

§ 11. [Repeal]

The following acts and parts of acts are repealed:

(1)

(2)

(3)

Library References

Statutes ⇐152. C.J.S. Statutes § 282.

JOHN K. VAN DE KAMP
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October 31, 1988

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

Dear Stan:

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

At the request of the Commission Chairman and John DeMoully, I am writing to expand on the comments previously made by the Office of the Attorney General with respect to this matter. It is my understanding that "UMIFA" is now scheduled for discussion at the Commission's December, 1988 meeting.

As I indicated in my discussion with John DeMoully on October 24, 1988, while the Office of the California Attorney General is not unalterably opposed to any modification of the current system, we are extremely concerned that the present proposal has far greater ramifications than are being anticipated. By way of background UMIFA was originally enacted in 1973 and made applicable to a very limited range of charities. In 1973, California had no comprehensive statutory scheme establishing appropriate fiduciary standards for charitable corporations. Rather, general trust law standards were applied to such charities. People v. Larkin 413 F.Supp. 978 (N.D. Cal. 1976).

Because of concerns on the part of many charitable organizations that the strict fiduciary standards contained in the trust law were too stringent for directors of charitable corporations, considerable study was given to creating a comprehensive statutory system establishing appropriate standards of conduct for charitable corporations. In 1978, the Legislature enacted the New Non-Profit Corporations Law (Corp. Code 5000 et seq.) which contained a set of carefully conceived fiduciary standards covering both director's duties of care (Corp. Code § 5231) and investment decisions (Corp. Code § 5240).

One of our primary problems with the proposed extension of UMIFA is that it creates a second conflicting set of standards regarding director investment decisions which are

at odds with the carefully drafted provisions of the Corporations Code. For example, a comparison of Corporations Code section 5231 and proposed section 18506 indicates that the "good faith," "best interests of the corporation" and "reasonable inquiry" provisions contained in Corporations Code section 5231 are not present in proposed section 18506. These provisions are, however, key to the protections built into the non-profit corporations law to protect the interests of the charitable beneficiaries. Similarly, the standards for investments contained in Corporations code section 5240 are at odds with the provisions contained in proposed section 18504. We feel that the Legislature, in enacting the new non-profit Corporations Code five years after UMIFA, believed that the higher standards of care contained therein were the appropriate fiduciary standards, i.e. that the charitable beneficiaries were entitled to this level of protection. As such we are opposed to creating a second, weaker fiduciary standard of care in the investment area.

We are also extremely concerned over the provisions of proposed section 18507 which substantially changes California's law with respect to the doctrine of cy pres. At present, California law is reasonably clear that the terms of a trust must be adhered to unless it would be illegal, impossible, or defeating of the trust purpose to do so. Estate of Loring 29 Cal.2d 423; Estate of Maybury 54 Cal.App.3d 969; Restatement of Trusts (2d), §399; Bogert, Trusts and Trustees (2d ed.) section 439. Proposed section 18507 would replace these long-standing rules with a test of "obsolescence" - a much more subjective and uncertain term. We feel strongly that the present standards have served the public well and safeguarded the integrity of trust asset and purposes. As such, we oppose a gratuitous change in this standard absent a strong showing of significant problems under existing legal standards.

Finally, as we expressed in our September 26, 1988 letter, we remain concerned over potential problems in permitting expenditures of unrealized gains in appreciation of principal assets particularly since this is, by definition, in violation of the express restriction under which the trustee accepted the gift. Moreover, in light of the increasing volatility of the stock markets, we believe far more inquiry should be conducted in this regard before the expansion of the UMIFA provisions to all charities, regardless of size or nature.

We appreciate the opportunity to provide input with respect to this issue and I will look forward to seeing you at the December meeting.

Very truly yours,

JOHN K. VAN DE KAMP
Attorney General

JAMES R. SCHWARTZ
Deputy Attorney General

JRS:ft

cc: John DeMoully

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January 4, 1989

Stan Ullerich, Esq.
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Re: Proposed Revisions to the Uniform Management of Institutional Funds Act ("UMIFA")

Dear Mr. Ullerich:

I am writing to you on behalf of the Marin Community Foundation ("MCF"), one of the co-trustees of the Buck Trust ("the Trust"), a charitable trust serving Marin County. MCF opposes the proposed changes to Section 18507 of the UMIFA, which would alter the legal standard to determine whether to release a restriction in a gift instrument.

The Buck Trust was established by the will of Mrs. Beryl Buck, who included a Marin-only restriction with respect to distribution of the Trust funds. As you may know, the San Francisco Foundation, MCF's predecessor as distribution trustee of the Trust, filed a petition in 1984 arguing that due to the increase in the size of the Trust since the time Mrs. Buck wrote her will, it was impracticable, inexpedient and inefficient to comply with the Marin-only restriction. The San Francisco Foundation did not argue that California's cy pres doctrine applied to the Trust or that distributing the proceeds of the Trust would be illegal or impossible. Rather, the petition argued that the money generated by the Trust could be better spent outside of Marin, even though all of Marin's charitable needs had not been met.

The Marin Council of Agencies ("MCA"), a group of charitable organizations in Marin who were beneficiaries of the Trust, was one of the parties opposing the San Francisco Foundation's petition. I am enclosing a copy of the MCA's trial brief, which sets forth the cy pres doctrine as

currently applied in California. The courts have invoked the cy pres doctrine only where the expressed or specific charitable purpose of the donor has become permanently illegal or impossible to fulfill. Trial Brief, p. 6. As the brief points out, the courts have uniformly rejected any use of the cy pres doctrine which would allow a court to re-write the will of the donor, even if the court disagrees with the gift or if other uses of the gift appear to be more useful or desirable. Trial Brief, pp. 6-9, 12-18. The courts' reluctance to invoke the doctrine stems from the policy of preserving the right of a testator to dispose of his property as he wishes, and thus to encourage charitable gifts. Trial Brief, pp. 22-23.

After three and one-half years of expensive litigation over the San Francisco Foundation's petition, the Court refused to release the geographic restriction of the Trust. I am enclosing a copy of the Court's Statement of Decision. The Court found that even if the increase in the size of the Trust had made the geographic restriction obsolete, the cy pres doctrine could not be used to release that restriction for the benefit of those outside of the county whose needs were arguably greater. Statement of Decision, p. 97n.6.

The standard proposed in Section 18507, allowing a court to release a restriction if it is "obsolete or impracticable," replicates the standard rejected by the Court in the Buck Trust litigation. The Court found that such a standard would violate the sanctity of a testator's charitable intent and vest too much discretion in a court or a trustee over whether to release a restriction in a charitable trust. The current cy pres doctrine promotes the continuity and stability of charitable trusts. The standard proposed in Section 18507 would both hinder charitable gift-giving and impede the administration of established trusts. The word "obsolete" is too vague to ensure a charitable donor that his gift will be a lasting legacy to his chosen beneficiaries. Indeed, this imprecise standard will discourage donors from making charitable gifts.

MCF objects to any changes in the law which would make it more attractive for persons seeking charitable funds to file lawsuits based upon a restriction in a charitable instrument that arguably has become "obsolete." Trust donors, beneficiaries, and administrators must be able to rely on the stability of charitable instruments.

MCF opposes draft Section 18507. California's current cy pres doctrine provides a workable standard for determining when to release restrictions in gift instruments.

Very truly yours,

Kathleen V. Fisher

KVF:mdr
Enclosures
cc: Douglas X. Patino (w/o enclosure)

B93407

Association of
Independent
California
Colleges and
Universities

January 17,1989

Stan Ulrich
Staff Counsel
California Law Revision Commission
4000 Middlefield Rd. , Suite D-2
Palo Alto, CA 94303-1335

Dear Stan,

In a recent letter you asked that I recount why the California statute of the Uniform Management of Insitutional Funds Act was constructed to exclude unrealized appreciation and to require a five year rolling average for fair value calculations. You also asked me to survey our membership about usage of the act's provisions. I have made such a request and hope to have some responses to you by the meeting at which you consider the matter.

In regard to the first set of questions, it would be helpful to discuss how the model statute was originally crafted and then explain why we agreed to the two modifications. At the outset I should comment that it was then, and is now, our position that the model statute (which includes unrealized appreciation and allows institutions to decide upon their own principles of fair value determinations) is the preferrable language.

Unfortunately, those of us who were there at the drafting of the original statute, save two, are no longer in their present positions. But after conferring with the other old codger who remains, I think I can reconstruct the events which led to the amendments to the model statute. The original intent of the model statute as proposed after a Ford Foundation study was to bring new methods of funds management to nonprofits. Ford argued for the adoption of a new principle which would give the chance for better resource management. The old standard of practice had the possibility that institutions would be limited to investments which concentrated on current return. Obviously, any institution which focussed its resources in that manner over the last twenty years was making very poor decisions over the long term.

When we originally proposed the California version of UMIFA we proposed the language in the model statute. The representative of the Attorney General's Registry of Charitable Trusts demanded that we accept both provisions. Their basic reasoning was that the inclusion of unrealized appreciation would encourage charities to waste their assets. The five year calculation was also seen as a brake on potentially reckless behavior.

In reality, the experience from the almost 30 states which have enacted a version of UMIFA suggests that the Ford Foundation's assumptions were closer to the mark. To my knowledge, there is virtually no evidence, in this state or others, that charities have used the new authority in an irresponsible manner. Only one other state (Kansas) also omits unrealized appreciation from the calculations of fair value. The effect in California has been to increase transaction costs. Our

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916 446-7626

institutions have been forced to liquidate investments in order to utilize them. One would not do that in a personal portfolio, it is no more logical that charities should be required to make such transactions.

There is one other effect suggested by the liquidation requirement. While no reply has commented on this topic, the possibility exists that the requirement may tend to discourage smaller institutions from utilizing the provisions of the act, or alternatively it may tend to force institutions to diversify their portfolio beyond what a normal investment decision would suggest. Modern investment theory tends to try and optimize a portfolio in terms of both timing and risk. While those decisions are being made there is also attention to assure that the portfolio is neither overly diversified nor under diversified. In a large endowment a manager can choose among available assets which fit a desired profile, when making a decision about liquidation. In a smaller endowment a funds manager might be forced to increase the number of items in the portfolio to be assured that the right blend of appreciated assets would be present at the time when the institution was thinking about funding a particular policy.

The five year averaging was introduced to smooth momentary fluctuations in the value of assets. While we would agree that such a standard is prudent, we would argue that such detail is inappropriate in the statute. I think only two other states establish an average for calculation. The Massachusetts statute limits total expenditures to seven percent of the value of the endowment, averaged over a three year period. The Ohio statute limits appropriation to 50% of the net appreciation of the endowment. The experience from the other states and from California suggests that no such limitation is desirable. Economic conditions change, it seems most appropriate in the statute to allow the financial managers of charitable institutions to determine which policies fit their setting. The Corporations Code has ample sanctions available for managers who make imprudent decisions.

My experience with colleges suggests that spending policies generally utilize something different than a five year rolling average. It seems appropriate that those institutions have the flexibility to determine which policy is most appropriate. I believe that it is unlikely that insitutions will adopt a spending policy which would be imprudent and that even if they did that the Attorney General would still have the opportunity to go after charities which acted irresponsibly.

I will be glad to supply you with the greater detail from our survey, as soon as it becomes available. The preliminary responses suggest that the Act has been quite useful to those institutions which have utilized it. The uniform response which I have gotten from our Chief Financial Officers about the Act can be summarized in two principles. First, the CFOs have used the Act responsibly. The Act has offered institutions an ability for what one CFO called greater "self sufficiency". The general evidence suggests that less sophisticated institutions have not utilized its provisions. Those that have have used it well. Among our institutions there are several financial officers who are investment managers who have received national recognition for their performance. The possibility that a charity would be spent into oblivion because it is allowed to use UMIFA is simply not demonstrated in the experience to date, either in California or in other states with broader statutes.

Second, the two current restrictions in the Act have neither improved the safety of the Act or helped to achieve the original goals. Thus, we would be supportive including unrealized appreciation and of modifying or eliminating the rolling average rule, within the proposed revision of the Act. Thanks for your continued efforts to understand the issues in this complex area.

Sincerely,

Jonathan Brown
Vice President

EXHIBIT 5

Selected Corporations Code Sections

From Nonprofit Public Benefit Corporation Law:

§ 5230. Duties and liabilities of directors of nonprofit public benefit corporation

(a) Any duties and liabilities set forth in this article shall apply without regard to whether a director is compensated by the corporation.

(b) Part 4 (commencing with Section 16000) of Division 9 of the Probate Code does not apply to the directors of any corporation.

§ 5231. Director to perform duties in good faith: Good faith reliance on official corporate information, opinions, and records: Liability of directors

(a) A director shall perform the duties of a director, including duties as a member of any committee of the board upon which the director may serve, 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.

(b) In performing the duties of a director, a director shall be entitled to rely on information, opinions, reports or statements, including financial statements and other financial data, in each case prepared or presented by:

(1) One or more officers or employees of the corporation whom the director believes to be reliable and competent in the matters presented;

(2) Counsel, independent accountants or other persons as to matters which the director believes to be within such person's professional or expert competence; or

(3) A committee of the board upon which the director does not serve, as to matters within its designated authority, which committee the director believes to merit confidence,

so long as, in any such case, the director acts in good faith, after reasonable inquiry when the need therefor is indicated by the circumstances and without knowledge that would cause such reliance to be unwarranted.

(c) Except as provided in Section 5233, a person who performs the duties of a director in accordance with subdivisions (a) and (b) shall have no liability based upon any alleged failure to discharge the person's obligations as a director, including, without limiting the generality of the foregoing, any actions or omissions which exceed or

defeat a public or charitable purpose to which a corporation, or assets held by it, are dedicated.

§ 5231.5. Liability of nonpaid director for good faith performance of duties

Except as provided in Section 5233 or 5237, there is no monetary liability on the part of, and no cause of action for damages shall arise against, any nonpaid director, including any nonpaid director who is also a nonpaid officer, of a nonprofit public benefit corporation based upon any alleged failure to discharge the person's duties as director or officer if the duties are performed in a manner that meets all of the following criteria:

(a) The duties are performed in good faith.

(b) The duties are performed in a manner such director believes to be in the best interests of the corporation

(c) The duties are performed with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances.

§ 5240. Applicability; Investment criteria

(a) This section applies to all assets held by the corporation for investment. Assets which are directly related to the corporation's public or charitable programs are not subject to this section.

(b) Except as provided in subdivision (c), in investing, reinvesting, purchasing, acquiring, exchanging, selling and managing the corporation's investments, the board shall do the following:

(1) Avoid speculation, looking instead to the permanent disposition of the funds, considering the probable income, as well as the probable safety of the corporation's capital.

(2) Comply with additional standards, if any, imposed by the articles, bylaws or express terms of an instrument or agreement pursuant to which the assets were contributed to the corporation.

(c) No investment violates this section where it conforms to provisions authorizing such investment contained in an instrument or agreement pursuant to which the assets were contributed to the corporation. No investment violates this section or Section 5231 where it conforms to provisions requiring such investment contained in an instrument or agreement pursuant to which the assets were contributed to the corporation.

(d) In carrying out duties under this section, each director shall act as required by subdivision (a) of Section 5231, may rely upon others as permitted by subdivision (b) of Section 5231, and shall have the benefit of subdivision (c) of Section 5231, and the board may delegate its investment powers as permitted by Section 5210.

(e) Nothing in this section shall be construed to preclude the application of the Uniform Management of Institutional Funds Act, Chapter 3 (commencing with Section 2290.1) of Title 8 of Part 4 of Division 3 of the Civil Code, if that act would otherwise be applicable.

§ 5241. Authority of court to direct or permit deviations from trust or other agreement: Notice to Attorney General

Nothing in Section 5240 shall abrogate or restrict the power of the appropriate court in proper cases to direct or permit a corporation to deviate from the terms of a trust or agreement regarding the making or retention of investments. Notice of such action or proceeding shall be given to the Attorney General who may intervene.

From Nonprofit Mutual Benefit Corporation Law:

§ 7230. Duties and liabilities of directors of nonprofit mutual benefit corporation

(a) Any duties and liabilities set forth in this article shall apply without regard to whether a director is compensated by the corporation.

(b) Part 4 (commencing with Section 16000) of Division 9 of the Probate Code does not apply to the directors of any corporation.

§ 7231. Director to perform duties in good faith: Good faith reliance on official corporate information, opinions, and records: Liability of directors

(a) A director shall perform the duties of a director, including duties as a member of any committee of the board upon which the director may serve, 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.

(b) In performing the duties of a director, a director shall be entitled to rely on information, opinions, reports or statements, including financial statements and other financial data, in each case prepared or presented by:

(1) One or more officers or employees of the corporation whom the director believes to be reliable and competent in the matters presented;

(2) Counsel, independent accountants or other persons as to matters which the director believes to be within such person's professional or expert competence; or

(3) A committee of the board upon which the director does not serve, as to matters within its designated authority, which committee the director believes to merit confidence,

so long as, in any such case, the director acts in good faith, after reasonable inquiry when the need therefor is indicated by the circumstances and without knowledge that would cause such reliance to be unwarranted.

(c) A person who performs the duties of a director in accordance with subdivisions (a) and (b) shall have no liability based upon any alleged failure to discharge the person's obligations as a director, including, without limiting the generality of the foregoing, any actions or omissions which exceed or defeat a public or charitable purpose to which assets held by a corporation are dedicated.

§ 7231.5. Monetary liability of volunteer director or volunteer executive committee officer

(a) Except as provided in Section 7233 or 7236, there is no monetary liability on the part of, and no cause of action for damages shall arise against, any volunteer director or volunteer executive committee officer of a nonprofit mutual benefit corporation based upon any alleged failure to discharge the person's duties as a director or officer if the duties are performed in a manner that meets all of the following criteria:

(1) The duties are performed in good faith.

(2) The duties are performed in a manner such director or officer believes to be in the best interests of the corporation.

(3) The duties are performed with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances.

(b) "Volunteer" means the rendering of services without compensation. "Compensation" means remuneration whether by way of salary, fee, or other consideration for services rendered. However, the payment of per diem, mileage, or other reimbursement expenses to a director or executive committee officer does not affect that person's status as a volunteer within the meaning of this section.

(c) "Executive committee officer" means the president, vice president, secretary, or treasurer of a corporation who assists in establishing the policy of the corporation.

(d) This section shall apply only to trade, professional, and labor organizations incorporated pursuant to this part which operate exclusively for fraternal, educational, and other nonprofit purposes, and under the provisions of Section 501(c) of the United States Internal Revenue Code.

§ 7238. Directors: Standard of conduct in respect to its assets held in charitable trust

Where a corporation holds assets in charitable trust, the conduct of its directors or of any person performing functions similar to those performed by a director, shall, in respect to the assets held in charitable trust, be governed by the standards of conduct set forth in Article 3 (commencing with Section 5230) of Chapter 2 of Part 2 for directors of nonprofit public benefit corporations. This does not limit any additional requirements which may be specifically set forth in this part regarding corporations holding assets in charitable trust.

From Nonprofit Religious Corporation Law:

§ 9240. Duties and liabilities of directors of nonprofit religious corporation

(a) Any duties and liabilities set forth in this article shall apply without regard to whether a director is compensated by the corporation.

(b) Part 4 (commencing with Section 16000) of Division 9 of the Probate Code does not apply to the directors of any corporation.

(c) A director, in making a good faith determination, may consider what the director believes to be:

(1) The religious purposes of the corporation; and

(2) Applicable religious tenets, canons, laws, policies, and authority.

§ 9241. Director to perform duties in good faith: Good faith reliance upon corporate information, opinions, and records: Liability of directors

(a) A director shall perform the duties of a director, including duties as a member of any committee of the board upon which the director may serve, 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 is appropriate under the circumstances.

(b) In performing the duties of a director, a director shall be entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data, in each case prepared or presented by:

(1) One or more officers or employees of the corporation whom the director believes to be reliable and competent in the matters presented;

(2) Counsel, independent accountants, or other persons as to matters which the director believes to be within such person's professional or expert competence;

(3) A committee of the board upon which the director does not serve, as to matters within its designated authority, which committee the director believes to merit confidence; or

(4) Religious authorities and ministers, priests, rabbis, or other persons whose position or duties in the religious organization the director believes justify reliance and confidence and whom the director believes to be reliable and competent in the matters presented, so long as, in any such case, the director acts in good faith, after reasonable inquiry when the need therefor is indicated by the circumstances, and without knowledge that would cause such reliance to be unwarranted.

(c) The provisions of this section, and not Section 9243, shall govern any action or omission of a director in regard to the compensation of directors, as directors or officers, or any loan of money or property to or guaranty of the obligation of any director or officer. No obligation, otherwise valid, shall be voidable merely because directors who

benefited by a board resolution to pay such compensation or to make such loan or guaranty participated in making such board resolution.

(d) Except as provided in Section 9243, a person who performs the duties of a director in accordance with subdivisions (a) and (b) shall have no liability based upon any alleged failure to discharge his or her obligations as a director, including, without limiting the generality of the foregoing, any actions or omissions which exceed or defeat any purpose to which the corporation, or assets held by it, may be dedicated.

§ 9250. Standards required of board

In investing, reinvesting, purchasing, acquiring, exchanging, selling, and managing a corporation's investments, the board shall meet the standards set forth in Section 9241.

§ 9251. Authority of court to direct or permit corporation to deviate from trust or other agreement

Nothing in Section 9250 shall abrogate or restrict the power of a court in proper cases to direct or permit a corporation to deviate from the terms of a trust or agreement regarding the making or retention of investments.

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TENTATIVE RECOMMENDATION

relating to

REVISION OF THE UNIFORM MANAGEMENT OF INSTITUTIONAL FUNDS ACT

California enacted the Uniform Management of Institutional Funds Act in 1973 as a pilot study, subject to a five-year sunset clause and restricted to certain accredited private colleges and universities.[1] The official text of the Uniform Management of Institutional Funds Act has a much broader scope, applying to private educational, religious, charitable, and eleemosynary institutions and to governmental organizations holding funds for such purposes.[2] Apparently, the pilot study was successful, since the sunset provision was repealed in 1978.[3] However, the restricted scope of the act was retained and the authority to use unrealized, as opposed to realized, appreciation was deleted from the statute.[4]

The Commission recommends that the California version of the Uniform Management of Institutional Funds Act be applied to the same organizations covered by the original uniform act. No persuasive reasons have been given for continuing the restrictions that applied under the original pilot study. None of the other 29 jurisdictions that have enacted the uniform act have so drastically restricted its scope.[5] The problems faced by charitable organizations that are

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1. See 1973 Cal. Stat. ch. 950, § 1 (enacting Civil Code §§ 2290.1-2290.12). The sunset clause was enacted by 1973 Cal. Stat. ch. 950, § 3. The act was moved to Education Code Sections 94600-94610 when the Civil Code trust provisions were generally repealed in connection with enactment of the new Trust Law. See 1986 Cal. Stat. ch. 820, §§ 7, 24.

2. See Unif. Management Inst. Funds Act § 1(1) (1972).

3. 1973 Cal. Stat. ch. 806, § 1.

4. 1978 Cal. Stat. ch. 806, § 2.

5. See annotations at 7A U.L.A. 714-27 (1985) & Supp. at 143-44 (1988).

treated by the uniform act are not unique to private colleges and universities.[6] The effect of this recommendation would be to extend the benefits of the uniform act to all educational, religious, charitable, or eleemosynary institutions. Specifically, these institutions would be able (1) to use appreciation of endowment funds subject to a fiduciary standard, (2) to delegate day-to-day investment management to committees and employees and hire investment advisory or management services, and (3) to release obsolete or impracticable restrictions on use of endowment funds with the donor's consent or on petition to court and notice to the Attorney General.[7] Extending the act's application would also provide guidance as to the board's power to invest and manage property and the standard of care governing the exercise of the board's powers[8] where the board is not governed by some other statute.[9]

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6. In addition, the Commission recommends that the act be moved to the Probate Code. The Education Code is not an ideal location if the act's coverage is expanded beyond private colleges and universities. It is appropriate to place the expanded act with the Trust Law, since the Trust Law also applies to charitable trusts. See Prob. Code § 15004.

7. For the existing provisions that would apply under a broadened statute, see Educ. Code §§ 94602 (use of appreciation), 94605 (delegation of authority), 94607 (release of restrictions). See generally Prefatory Note, Unif. Management Inst. Funds Act (1972), 7A U.L.A. 706-09 (1985).

8. For the existing provisions that would apply under a broadened statute, see Educ. Code §§ 94604 (investment authority), 94606 (standard of care).

9. The proposed law would provide that UMIFA does not alter the duties and liabilities of governing boards under other laws. See, e.g., Corp. Code §§ 5231-5231.5 (directors of nonprofit public benefit corporations), 7231-7231.5 (directors of nonprofit mutual benefit corporations), 9240-9241 (directors of nonprofit religious corporations).

The Commission's recommendation would be effectuated by enactment of the following measure:

An act to amend Section 5240 of the Corporations Code, to add Part 7 (commencing with Section 18500) to Division 9 of the Probate Code, and to repeal Chapter 6 (commencing with Section 94600) of Part 59 of Division 10 of Title 3 of the Education Code, relating to the Uniform Management of Institutional Funds Act.

The people of the State of California do enact as follows:

Corporations Code § 5240 (amended). Investments under Nonprofit Public Benefit Corporations Law

SECTION 1. Section 5240 of the Corporations Code is amended to read:

5240. (a) This section applies to all assets held by the corporation for investment. Assets which are directly related to the corporation's public or charitable programs are not subject to this section.

(b) Except as provided in subdivision (c), in investing, reinvesting, purchasing, acquiring, exchanging, selling and managing the corporation's investment, the board shall do the following:

(1) Avoid speculation, looking instead to the permanent disposition of the funds, considering the probable income, as well as the probable safety of the corporation's capital.

(2) Comply with additional standards, if any, imposed by the articles, bylaws or express terms of an instrument or agreement pursuant to which the assets were contributed to the corporation.

(c) No investment violates this section where it conforms to provisions authorizing such investment contained in an instrument or agreement pursuant to which the assets were contributed to the corporation. No investment violates this section or Section 5231 where it conforms to provisions requiring such investment contained in an instrument or agreement pursuant to which the assets were contributed to the corporation.

(d) In carrying out duties under this section, each director shall

act as required by subdivision (a) of Section 5231, may rely upon others as permitted by subdivision (b) of Section 5231, and shall have the benefit of subdivision (c) of Section 5231, and the board may delegate its investment powers as permitted by Section 5210.

(e) Nothing in this section shall be construed to preclude the application of the Uniform Management of Institutional Funds Act, ~~Chapter 3~~ Part 7 (commencing with Section ~~2290.1~~ 18500) of ~~Title 8 of Part 4 of~~ Division ~~3~~ 9 of the ~~Civil~~ Probate Code, if that act would otherwise be applicable.

Comment. Subdivision (e) of Section 5240 is revised to correct a cross-reference.

Education Code §§ 18500-18508 (repealed). Uniform Management of Institutional Funds Act

SEC 2. Chapter 6 (commencing with Section 94600) of Part 59 of Division 10 of Title 3 of the Education Code is repealed.

Note. Comments to repealed sections are set out at the end of the recommendation.

Probate Code §§ 18500-18508 (added). Uniform Management of Institutional Funds Act

SEC. 3. Part 7 (commencing with Section 18500) is added to Division 9 of the Probate Code, to read:

PART 7. UNIFORM MANAGEMENT OF INSTITUTIONAL FUNDS ACT

§ 18500. Short title

18500. This part may be cited as the Uniform Management of Institutional Funds Act.

Comment. Section 18500 continues Education Code Section 94600 without change. The Uniform Management of Institutional Funds Act has been relocated from the Education Code, where it applied only to certain private institutions of higher education. See Section 18501(e) and the Comment thereto. See also Sections 2(b) (interpretation of uniform acts), 11 (severability).

§ 18501. Definitions

18501. As used in this part:

(a) "Endowment fund" means an institutional fund, or any part

thereof, not wholly expendable by the institution on a current basis under the terms of the applicable gift instrument.

(b) "Gift instrument" means a will, deed, grant, conveyance, agreement, memorandum, writing, or other governing document (including the terms of any institutional solicitations from which an institutional fund resulted) under which property is transferred to or held by an institution as an institutional fund.

(c) "Governing board" means the body responsible for the management of an institution or of an institutional fund.

(d) "Historic dollar value" means the aggregate fair value in dollars of (1) an endowment fund at the time it became an endowment fund, (2) each subsequent donation to the endowment fund at the time it is made, and (3) each accumulation made pursuant to a direction in the applicable gift instrument at the time the accumulation is added to the endowment fund.

(e) "Institution" means an incorporated or unincorporated organization organized and operated exclusively for educational, religious, charitable, or other eleemosynary purposes, or a governmental organization to the extent that it holds funds exclusively for any of these purposes.

(f) "Institutional fund" means a fund held by an institution for its exclusive use, benefit, or purposes, but does not include (1) a fund held for an institution by a trustee that is not an institution or (2) a fund in which a beneficiary that is not an institution has an interest, other than possible rights that could arise upon violation or failure of the purposes of the fund.

Comment. Section 18501 restates former Education Code Section 94601 without substantive change, except that the definition of "institution" has been substantially expanded. As revised, the definition of "institution" is the same as that provided in Section 1(1) of the Uniform Management of Institutional Funds Act (1972). Former Education Code Section 94601(a) defined "institution" as a "private incorporated or unincorporated organization organized and operated exclusively for educational purposes and accredited by the Association of Western Colleges and Universities to the extent that it holds funds exclusively for any of such purposes."

Section 18501 lists the definitions in alphabetical order, unlike former Education Code Section 94601. The definition of "historic dollar value" in subdivision (d) has been revised by adding "endowment" preceding "fund" in the second and third clauses.

§ 18502. Expenditure of asset net appreciation for current use

18502. The governing board may appropriate for expenditure for the uses and purposes for which an endowment fund is established so much of the realized net appreciation in the fair value of the assets of an endowment fund over the historic dollar value of the fund as is prudent under the standard established by Section 18506. This section does not limit the authority of the governing board to expend funds as permitted under other law, the terms of the applicable gift instrument, or the charter of the institution.

Comment. The first sentence of Section 18502 restates the first sentence of former Education Code Section 94602 without substantive change. The phrase "net appreciation, realized in the fair value" has been revised for clarity to read "realized net appreciation in the fair value." See the Comment to Section 18500.

The second sentence of Section 18502 continues the third sentence of former Education Code Section 94602 without change. The second sentence of former Education Code Section 94602, providing a rolling five-year averaging rule, has been omitted as obsolete since the elimination of authority to appropriate unrealized net appreciation by amendment in 1978. See 1978 Cal. Stat. ch. 806, § 2, amending former Civil Code § 2290.2, the predecessor to former Educ. Code § 94602.

Note. The first sentence of this section has been revised to implement the Commission's provisional decision at the December meeting. As discussed in Memorandum 89-13, the predecessor of this provision was amended to eliminate the power to appropriate unrealized appreciation when the sunset clause was repealed in 1978. Section 2 of the uniform act in relevant part provides as follows:

> *The governing board may appropriate for expenditure for the uses and purposes for which an endowment fund is established so much of the net appreciation, realized and unrealized, in the fair value of the assets of an endowment fund over the historic dollar value of the fund as is prudent under the standard established by Section 6.*

The staff recommends that the authority to use unrealized appreciation be restored for the reasons discussed in the memorandum.

As noted in the Comment, we have omitted the second sentence of the California variation since it does not have any identifiable relevance to appropriations based on realized appreciation. The second sentence of the existing section reads as follows:

> *Appropriations shall be based upon an average fair value covering a period of up to the five preceding fiscal years of the institution and shall be set at any reasonable date prior to each fiscal year.*

There does not appear to be any way that the five-year rule could apply to realized appreciation. What is there to average? It might be

appropriate to restore the five-year rule if authority to utilize unrealized appreciation is also restored to the section.

§ 18503. Construction of gift instrument

18503. (a) Section 18502 does not apply if the applicable gift instrument indicates the donor's intention that net appreciation shall not be expended.

(b) If the gift instrument includes a designation of the gift as an endowment or a direction or authorization to use only "income," "interest," "dividends," or "rents, issues, or profits," or "to preserve the principal intact," or a direction or authorization that contains other words of similar meaning:

(1) A restriction on the expenditure of net appreciation need not be implied solely from the designation, direction, or authorization, if the gift instrument became effective before the Uniform Management of Institutional Funds Act became applicable to the institution.

(2) A restriction on the expenditure of net appreciation may not be implied solely from the designation, direction, or authorization, if the gift instrument becomes effective after the Uniform Management of Institutional Funds Act became applicable to the institution.

(c) The effective dates of the Uniform Management of Institutional Funds Act are the following:

(1) January 1, 1974, with respect to a private incorporated or unincorporated organization organized and operated exclusively for educational purposes and accredited by the Association of Western Colleges and Universities.

(2) January 1, 1990, with respect to an institution not described in paragraph (1).

Comment. Subdivisions (a) of Section 18503 continues former Education Code Section 94603(a) without change. Subdivisions (b) and (c)(1) restate former Education Code Section 94603(b) without substantive change. Subdivision (c)(2) applies a consistent rule of construction to institutions (as defined in Section 18501(e)) that were not covered by the former law. See the Comment to Section 18501.

Note. The California version differs from the uniform language, but the California version makes important distinctions based on the effective date of the gift instrument.

§ 18504. Investment authority

18504. In addition to an investment otherwise authorized by law or by the applicable gift instrument, the governing board, subject to any specific limitations set forth in the applicable gift instrument, may do any or all of the following:

(a) Invest and reinvest an institutional fund in any real or personal property deemed advisable by the governing board, whether or not it produces a current return, including mortgages, stocks, bonds, debentures, and other securities of profit or nonprofit corporations, shares in or obligations of associations, or partnerships, and obligations of any government or subdivision or instrumentality thereof.

(b) Retain property contributed by a donor to an institutional fund for as long as the governing board deems advisable.

(c) Include all or any part of an institutional fund in any pooled or common fund maintained by the institution.

(d) Invest all or any part of an institutional fund in any other pooled or common fund available for investment, including shares or interests in regulated investment companies, mutual funds, common trust funds, investment partnerships, real estate investment trusts, or similar organizations in which funds are commingled and investment determinations are made by persons other than the governing board.

Comment. Section 18504 continues former Education Code Section 94604 without change, except that an unnecessary comma following the word "associations" in subdivision (a) has been omitted. See the Comment to Section 18500.

§ 18505. Delegation of authority

18505. Except as otherwise provided by the applicable gift instrument or by applicable law relating to governmental institutions or funds, the governing board may do the following:

(a) Delegate to its committees, officers, or employees of the institution or the fund, or agents, including investment counsel, the authority to act in place of the board in investment and reinvestment of institutional funds.

(b) Contract with independent investment advisers, investment counsel or managers, banks, or trust companies, so to act.

(c) Authorize the payment of compensation for investment advisory or management services.

Comment. Section 18505 continues former Education Code Section 94605 without change.

§ 18506. Standard of care

18506. (a) When investing, reinvesting, purchasing, acquiring, exchanging, selling, and managing property, appropriating appreciation, and delegating investment management for the benefit of an institution, the members of the governing board shall act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of like character and with like aims to accomplish the purposes of the institution. In the course of administering the fund pursuant to this standard, individual investments shall be considered as part of an overall investment strategy.

(b) In exercising judgment under this section, the members of the governing board shall consider the long and short term needs of the institution in carrying out its educational, religious, charitable or other eleemosynary purposes, its present and anticipated financial requirements, expected total return on its investments, general economic conditions, the appropriateness of a reasonable proportion of higher risk investment with respect to institutional funds as a whole, income, growth, and long-term net appreciation, as well as the probable safety of funds.

Comment. Section 18506 restates former Education Code Section 94606 without substantive change. See the Comment to Section 18500. The standard of care in subdivision (a) is consistent with the general standard of care provided by Section 16040.

Note. As discussed in the memorandum, this section differs significantly from Section 6 of UMIFA. As noted in the Comment, subdivision (a) supplants the UMIFA standard of care.

We have added the description of purposes that was omitted from the California version as a necessary result of the limited scope of the pilot study act. But see Educ. Code § 94607(c) [draft Section 18507(c)] containing the same list of purposes, which was not omitted in the original California version.

§ 18507. Release of restriction in gift instruments

18507. (a) With the written consent of the donor, the governing board may release, in whole or in part, a restriction imposed by the

applicable gift instrument on the use or investment of an institutional fund.

(b) If written consent of the donor cannot be obtained by reason of the donor's death, disability, unavailability, or impossibility of identification, the governing board may apply in the name of the institution to the superior court of the county in which the principal activities of the institution are conducted, or other court of competent jurisdiction, for release of a restriction imposed by the applicable gift instrument on the use or investment of an institutional fund. No court has jurisdiction to release a restriction on an institutional fund under this part unless the Attorney General is a party to the proceedings. If the court finds that the restriction is obsolete or impracticable, it may by order release the restriction in whole or in part. A release under this subdivision may not change an endowment fund to a fund that is not an endowment fund.

(c) A release under this section may not allow a fund to be used for purposes other than the educational, religious, charitable, or other eleemosynary purposes of the institution affected.

(d) This section does not limit the application of the doctrine of cy pres.

Comment. Section 18507 restates former Education Code Section 94607 without substantive change. In the second sentence of subdivision (b), the phrase "release a restriction on" has been substituted for the phrase "modify any use of" in former Education Code Section 94607(b).

Note. The question of whether this section should continue the "obsolete or impracticable" standard is discussed at length in Memorandum 89-13. The staff would continue this section as set out.

§ 18508. Status of governing boards

18508. Nothing in this part alters the status of governing boards, or the duties and liabilities of directors, under other laws of this state.

Comment. Section 18508 continues former Education Code Section 94610 without change, except for the language relating to duties and liabilities of directors which is new. The purpose of this new provision is to make clear that the duties and liabilities of directors of incorporated institutions are governed by the relevant statute and not by this part. See, e.g., Corp. Code §§ 5231-5231.5 (directors of nonprofit public benefit corporations), 7231-7231.5 (directors of nonprofit mutual benefit corporations), 9240-9241 (directors of nonprofit religious corporations).

COMMENTS TO REPEALED SECTIONS

Education Code § 94600 (repealed). Short title

Comment. Former Section 94600 is continued in Probate Code Section 18500 without change. The Uniform Management of Institutional Funds Act has been moved from the Education Code since it has been expanded to apply to religious, charitable, and other eleemosynary institutions.

Education Code § 94601 (repealed). Definitions

Comment. Former Section 94601 is restated in Probate Code Section 18501 without substantive change, except that the definition of "institution" in subdivision (a) has been substantially expanded in the new provision. Additional technical changes have been made. See Prob. Code § 18501 and the Comment thereto.

Education Code § 94602 (repealed). Expenditure of asset net appreciation for current use

Comment. The first sentences of former Section 94602 is restated in Probate Code Section 18502 without substantive change. The second sentence is omitted as obsolete. See the Comment to Prob. Code § 18502. The third sentence is continued in the second sentence of Probate Code Section 18502 without change.

Education Code § 94603 (repealed). Construction of gift instrument

Comment. Former Section 94603 is restated in Probate Code Section 18503 without substantive change. See the Comment to Prob. Code § 18503.

Education Code § 94604 (repealed). Authority of board to invest and reinvest

Comment. Former Section 94604 is continued in Probate Code Section 18504 without change, except that the comma following the word "associations" in subdivision (a) is omitted.

Education Code § 94605 (repealed). Delegation of authority

Comment. Former Section 94605 is continued in Probate Code Section 18505 without change.

Education Code § 94606 (repealed). Standard of care

Comment. Former Section 94606 is restated in Probate Code Section 18506 without substantive change. See the Comment to Prob. Code § 18506.

Education Code § 94607 (repealed). Release of restriction in gift instruments

Comment. Former Section 94607 is restated in Probate Code Section 18507 without substantive change. See the Comment to Prob. Code § 18507.

Education Code § 94608 (repealed). Severability

Comment. Former Section 94608 is omitted because it is unnecessary. See Prob. Code § 11 (severability).

Education Code § 94609 (repealed). Application and construction

Comment. Former Section 94609 is omitted because it is unnecessary. See Prob. Code § 2(b) (interpretation of uniform acts).

Education Code § 94610 (repealed). Status of governing boards

Comment. Former Section 94610 is restated in Probate Code Section 18508 without substantive change. See the Comment to Prob. Code § 18507.