

2014

How Deep are the Springs of Obedience Norms that Bind the Overseers of Charities?

Johnny R. Buckles

Follow this and additional works at: <https://scholarship.law.edu/lawreview>



Part of the [Estates and Trusts Commons](#)

Recommended Citation

Johnny R. Buckles, *How Deep are the Springs of Obedience Norms that Bind the Overseers of Charities?*, 62 Cath. U. L. Rev. 913 (2013).

Available at: <https://scholarship.law.edu/lawreview/vol62/iss4/2>

This Article is brought to you for free and open access by CUA Law Scholarship Repository. It has been accepted for inclusion in Catholic University Law Review by an authorized editor of CUA Law Scholarship Repository. For more information, please contact edinger@law.edu.

How Deep are the Springs of Obedience Norms that Bind the Overseers of Charities?

Cover Page Footnote

Professor of Law and Law Foundation Professor, University of Houston Law Center. The author thanks Professor Evelyn Brody for helpful comments to a prior draft of this Article. The author also thanks the University of Houston for its financial support of this Paper, and the author's wife, Tami Buckles, for her constant support.

HOW DEEP ARE THE SPRINGS OF OBEDIENCE NORMS THAT BIND THE OVERSEERS OF CHARITIES?

Johnny Rex Buckles⁺

I. OBEDIENCE NORMS EXPLAINED AND ILLUSTRATED	920
A. <i>The Basic Nature of Obedience Norms</i>	920
B. <i>A Framework for Obedience Norms Explained and Illustrated</i>	921
1. <i>The Legality Norm</i>	921
2. <i>The Dynamic Charter Fidelity Norm</i>	921
3. <i>The Static Charter Fidelity Norm</i>	922
4. <i>The Dynamic Mission Fidelity Norm</i>	923
5. <i>The Historic Mission Fidelity Norm</i>	923
6. <i>The Charity Advancement Norm</i>	924
C. <i>Contexts for Applying Obedience Norms</i>	925
1. <i>Daily Operations</i>	925
2. <i>Formal Amendments to Charter</i>	925
3. <i>Use of Funds to Further Post-Amendment Charter Purposes</i> <i>or a New Mission</i>	926
4. <i>Distributions in Dissolution and Liquidation of a Charity</i>	927
D. <i>Co-Existence of Obedience Norms</i>	927
II. OBEDIENCE NORMS GOVERNING TRUSTEES OF CHARITABLE TRUSTS	928
A. <i>Trust Law in General</i>	928
1. <i>The Charter Fidelity Norm Under General Trust Law</i>	928
2. <i>The Legality Norm</i>	929
B. <i>Charitable Trust Law</i>	929
1. <i>The Charity Advancement Norm</i>	929
2. <i>Cy Pres, Equitable Deviation, the Legality Norm, and the</i> <i>Static Charter Fidelity Norm</i>	930
3. <i>Mission Fidelity</i>	931
III. OBEDIENCE NORMS GOVERNING DIRECTORS OF CHARITABLE NONPROFIT CORPORATIONS.....	932
A. <i>The Legality Norm</i>	932
B. <i>Charter Fidelity Norms</i>	932
1. <i>In General</i>	932
2. <i>The Dynamic Charter Fidelity Norm Predominates in the</i> <i>Context of Formal Adoption of Charter Amendments</i>	933

⁺ Professor of Law and Law Foundation Professor, University of Houston Law Center. The author thanks Professor Evelyn Brody for helpful comments to a prior draft of this Article. The author also thanks the University of Houston for its financial support of this Paper, and the author's wife, Tami Buckles, for her constant support.

3. What Charter Fidelity Norm Governs the Use of Assets Held Before and After a Charter Amendment?	934
a. The PLNO and Model Nonprofit Corporation Acts	934
b. Case Law Supporting the Static Charter Fidelity Norm	935
c. Case Law Supporting the Dynamic Charter Fidelity Norm	940
4. What Charter Fidelity Norm Governs the Distribution of Assets in Dissolution and Liquidation of a Charitable Nonprofit Corporation?	945
C. Mission Fidelity Norms	946
1. Support for the Historic Mission Fidelity Norm	947
2. Support for the Dynamic Mission Fidelity Norm	948
D. The Charity Advancement Norm	949
E. Summary	949
IV. THE PURPOSE OF OBEDIENCE NORMS	950
A. Public Benefit	950
B. Equity	952
C. Efficiency	955
D. Summary	959
V. IMPLEMENTING FIDUCIARY OBEDIENCE NORMS	959
VI. CONCLUSION AND IMPLICATIONS	963

Deep Springs College offers a unique educational experience. Founded in 1917, the college sits on a cattle ranch and alfalfa farm in the High Desert of California.¹ The intellectually-gifted students of Deep Springs combine rigorous academic study, manual labor, and self-governance to prepare for lives of service and leadership.² However, bright, young high school seniors seeking the singular brand of liberal arts education offered by Deep Springs need not apply if they are women.³ Who is responsible for this policy? It is not the overseers of the college, who have determined that the school should admit students of

1. *About Deep Springs*, DEEP SPRINGS COLLEGE, <http://www.deepsprings.edu/about> (last visited Sept. 30, 2013).

2. *Id.*

3. See Petition for Court Order Construing Trust Provisions, Or, If Necessary, Modifying the Trust Instrument at 3, *In re* L.L. Nunn Trust, No. SICVPB 12-53232 (Cal. Super. Ct. Mar. 9, 2012) [hereinafter Petition], available at <http://www.deepsprings.edu/downloads/Deep%20Springs%20Initial%20Coeducation%20Petition,%206%20Feb%202012> (explaining that Deep Springs has only admitted male students since it was founded).

both sexes.⁴ Instead, a California court recently enjoined the school from admitting female students in the first phase of lengthy litigation.⁵

The court issued the injunction after rejecting the college's argument that coeducation was permissible under a liberal construction of the 1923 Deed of Trust (the Trust) that endowed the school with a small fortune and described the school's charitable purposes as being "for the education of promising young men."⁶ Further complicating the situation, a nonprofit corporation formed in 1967 began operating the school in 1996 after it received liquid assets and real property from the original trust.⁷ The case, therefore, raises not only a trust construction issue, but also issues concerning the degree to which the corporation is bound by the original trust instrument, and whether (if the corporation is bound) the trustees have established grounds for judicially modifying the terms of trust. More broadly, the Deep Springs litigation raises the poignant question of to what degree the law should require charity managers to obey the precise charitable purposes historically advanced by the charities that they govern.

The trustees of Deep Springs College, like directors and trustees of other charitable organizations, are subject to two familiar fiduciary duties:⁸ the duty

4. See Press Release, Deep Springs College, Deep Springs College Has Decided to Admit Women (Sept. 19, 2011), available at <http://www.deepsprings.edu/downloads/DSPressRelease091911.PDF> (announcing that the trustees voted in favor of transitioning to a coeducational student body).

5. See Scott Jaschik, *Women Blocked at Deep Springs*, INSIDE HIGHER ED. (Jan. 11, 2013, 3:00 AM), <http://www.insidehighered.com/news/2013/01/11/judge-blocks-deep-springs-college-admitting-women> (providing a general synopsis of the litigation).

6. See *id.* (explaining that the court granted the injunction after concluding that, under the terms of the 1923 trust, the school does not have the authority to admit women); see also Petition, *supra* note 3, at 2–3 (explaining the terms of the trust).

7. See Petitioner's Opening Brief on Interpretation of the L.L. Nunn Trust at 2, *In re L.L. Nunn Trust*, No. SICVPB 12-53232 (Cal. Super. Ct. Feb. 6, 2012), available at <http://www.deepsprings.edu/downloads/Coeducation-Litigation/2012-10-03%20Trustees%20Opening%20Brief%20on%20Interpretation%20of%20the%20L.L.%20Nunn%20Trust.PDF>.

8. An extensive academic literature discusses and analyzes regulation of charity fiduciaries and the duties that they owe. See, e.g., Ellen P. Aprill, *What Critiques of Sarbanes-Oxley Can Teach About Regulation of Nonprofit Governance*, 76 *FORDHAM L. REV.* 765 (2007); Carter G. Bishop, *The Deontological Significance of Nonprofit Corporate Governance Standards: A Fiduciary Duty of Care Without a Remedy*, 57 *CATH. U. L. REV.* 701 (2008); Evelyn Brody, *Agents Without Principals: The Economic Convergence of the Nonprofit and For-Profit Organizational Forms*, 40 *N.Y.L. SCH. L. REV.* 457 (1996) [hereinafter *Agents Without Principals*]; Evelyn Brody, *Charity Governance: What's Trust Law Got to Do with It?*, 80 *CHI.-KENT L. REV.* 641 (2005); Evelyn Brody, *The Limits of Charity Fiduciary Law*, 57 *MD. L. REV.* 1400 (1998) [hereinafter *The Limits of Charity Fiduciary Law*]; Evelyn Brody, *Whose Public? Parochialism and Paternalism in State Charity Law Enforcement*, 79 *IND. L.J.* 937 (2004) [hereinafter *Whose Public?*]; Nina J. Crimm, *A Case Study of a Private Foundation's Governance and Self-Interested Fiduciaries Calls for Further Regulation*, 50 *EMORY L.J.* 1093 (2001); Deborah A. DeMott, *Self-Dealing Transactions in Nonprofit Corporations*, 59 *BROOK. L. REV.* 131 (1993); Melanie DiPietro, *Duty of Obedience: A Medieval Explanation for Modern Nonprofit Governance Accountability*, 46 *DUQ. L. REV.* 99 (2007); James J. Fishman, *Improving Charitable*

Accountability, 62 MD. L. REV. 218 (2003); Marion R. Fremont-Smith & Jonathan A. Lever, *State Regulation of Health Care Conversions and Conversion Foundations*, 9 HEALTH L. REP. 714 (2000); Christopher W. Frost, *Financing Public Health Through Nonprofit Conversion Foundations*, 90 KY. L.J. 935 (2002); Susan N. Gary, *Is it Prudent to be Responsible? The Legal Rules for Charities that Engage in Socially Responsible Investing and Mission Investing*, 6 NW. J. L. & SOC. POL'Y 106 (2011) [hereinafter Gary, *Socially Responsible Investing*]; Susan N. Gary, *Regulating the Management of Charities: Trust Law, Corporate Law, and Tax Law*, 21 U. HAW. L. REV. 593 (1999) [hereinafter Gary, *Trust Law*]; Harvey J. Goldschmid, *The Fiduciary Duties of Nonprofit Directors and Officers: Paradoxes, Problems, and Proposed Reforms*, 23 J. CORP. L. 631 (1998); Thomas L. Greaney & Kathleen M. Boozang, *Mission, Margin and Trust in the Nonprofit Health Care Enterprise*, 5 YALE J. HEALTH POL'Y L. & ETHICS 1 (2005); Henry Hansmann, *The Evolving Law of Nonprofit Organizations: Do Current Trends Make Good Policy?*, 39 CASE W. RES. L. REV. 807 (1989); Henry B. Hansmann, *Reforming Nonprofit Corporation Law*, 129 U. PA. L. REV. 497 (1981); Thomas Lee Hazen & Lisa Love Hazen, *Punctilios and Nonprofit Corporate Governance—A Comprehensive Look at Nonprofit Directors' Fiduciary Duties*, 14 U. PA. J. BUS. L. 347 (2012); Robert A. Katz, *Let Charitable Directors Direct: Why Trust Law Should Not Curb Board Discretion Over a Charitable Corporation's Mission and Unrestricted Assets*, 80 CHI.-KENT L. REV. 689 (2005); Geoffrey A. Manne, *Agency Costs and the Oversight of Charitable Organizations*, 1999 WIS. L. REV. 227 (1999); Jill S. Manny, *Governance Issues for Non-Profit Religious Organizations*, 40 CATH. LAW. 1 (2000); Lumen N. Mulligan, *What's Good for the Goose is not Good for the Gander: Sarbanes-Oxley -Style Nonprofit Reforms*, 105 MICH. L. REV. 1981 (2007); Alan R. Palmiter, *Duty of Obedience: The Forgotten Duty*, 55 N.Y.L. SCH. L. REV. 457 (2011); Dana Brakman Reiser, *Director Independence in the Independent Sector*, 76 FORDHAM L. REV. 795 (2007); Dana Brakman Reiser & Claire R. Kelly, *Linking NGO Accountability and the Legitimacy of Global Governance*, 36 BROOK. J. INT'L L. 1011 (2011); Norman I. Silber, *Nonprofit Interjurisdictionality*, 80 CHI.-KENT L. REV. 613 (2005); Linda Sugin, *Resisting the Corporatization of Nonprofit Governance: Transforming Obedience into Fidelity*, 76 FORDHAM L. REV. 893 (2007); John W. Vinson, *The Charity Oversight Authority of the Texas Attorney General*, 35 ST. MARY'S L.J. 243 (2004); Chris Abbinante, Comment, *Protecting "Donor Intent" in Charitable Foundations: Wayward Trusteeship and the Barnes Foundation*, 145 U. PA. L. REV. 665 (1997); Jeremy Benjamin, Note, *Reinvigorating Nonprofit Directors' Duty of Obedience*, 30 CARDOZO L. REV. 1677 (2009); Denise Ping Lee, Note, *The Business Judgment Rule: Should It Protect Nonprofit Directors?*, 103 COLUM. L. REV. 925 (2003); Peggy Sasso, Comment, *Searching for Trust in the Not-for-Profit Boardroom: Looking Beyond the Duty of Obedience to Ensure Accountability*, 50 UCLA L. REV. 1485 (2003).

of loyalty⁹ and the duty of care¹⁰ (or prudent administration in the case of charitable trusts).¹¹ The law of trusts, including charitable trusts, also generally

9. Typically under state law, the extent of the duty of loyalty owed by charity fiduciaries depends on whether the charity is a trust or a nonprofit corporation. State nonprofit statutes usually require a director of a nonprofit charitable corporation to act in “good faith” and according to what she believes (or reasonably believes) is in the “best interests of the corporation.” *See, e.g.*, CAL. CORP. CODE § 5231(a) (West 2013); FLA. STAT. ANN. § 617.0830(1)(a), (c) (West 2007); MASS. GEN. LAWS ANN. ch. 180, § 6C (West 2010); OHIO REV. CODE ANN. § 1702.30(B) (LexisNexis 2009); 15 PA. CONS. STAT. ANN. § 5712(a) (West 1995); TEX. BUS. ORGS. CODE ANN. § 22.221(a) (West 2012). If the interests of a charitable nonprofit corporation conflict with the interests of directors and related persons, the duty of loyalty encourages directors to follow procedural safeguards. *See, e.g.*, CAL. CORP. CODE § 5233(d)(2)(C) (West 1990) (precluding a claim if a majority of directors approved the transaction that could pose a conflict of interest, so long as the directors knew all of the material facts and the interested directors did not vote); FLA. STAT. ANN. § 617.0832 (West 2013) (listing the procedural safeguards necessary for a nonprofit corporation’s transaction where one or more directors has a potential conflict of interest); 805 ILL. COMP. STAT. ANN. 105/108.60 (West 2010) (same); N.Y. NOT-FOR-PROFIT CORP. LAW § 715(a) (McKinney 2005) (same); TEX. BUS. ORGS. CODE ANN. § 22.230 (West 2012) (same); MODEL NONPROFIT CORP. ACT § 8.60(a) (3d ed. 2009) (stating that a conflict-of-interest transaction is not voidable if, in relevant part, the board of directors is informed of the material facts relating to the conflict and a majority of disinterested directors approve the transaction); *id.* § 8.31(a)(1)(ii) (stating that an interested director incurs no liability if the procedures outlined in § 8.60 have been followed). Generally, there is no outright prohibition against transactions between a director and the nonprofit corporation that she oversees. However, in those jurisdictions that follow the 1987 Revised Model Nonprofit Corporation Act (RMNCA), loans are prohibited between a director or officer and the corporation that she oversees or manages. REVISED MODEL NONPROFIT CORP. ACT § 8.32(a) (1987). An optional provision in the more recent Model Act generally forbids such loans. Model Nonprofit Corp. Act 3d ed. § 8.32(a).

Under traditional trust law, trustees of charitable trusts are more strictly prohibited from engaging in self-dealing than are corporate fiduciaries. *See* RESTATEMENT (THIRD) OF TRUSTS § 78 cmt. a (2007) (“The duty of loyalty is, for trustees, particularly strict even by comparison to the standards of other fiduciary relationships.”). The duty of loyalty “strictly prohibit[s]” the trustee “from engaging in transactions that involve self-dealing or that otherwise involve or create a conflict between the trustee’s fiduciary duties and personal interests,” except in “discrete circumstances.” *Id.* § 78(2).

10. As the duty of care is explained in the Principles of the Law of Nonprofit Organizations, a director must become adequately informed, devote appropriate attention to overseeing the charity’s affairs, and “act with the care that an ordinarily prudent person would reasonably exercise in a like position and under similar circumstances.” PRINCIPLES OF THE LAW OF NONPROFIT ORGS. § 315(a)–(b) (Tentative Draft No. 1, 2007). Similarly, the Revised Model Nonprofit Corporation Act, in relevant part, requires a director to discharge her duties “with the care an ordinarily prudent person in a like position would exercise under similar circumstances.” REVISED MODEL NONPROFIT CORP. ACT § 8.30(a)(2). Under the Model Nonprofit Corporation Act, Third Edition, directors “must discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances.” MODEL NONPROFIT CORP. ACT § 8.30(b). These standards are largely consistent with those set forth in many nonprofit corporation statutes. *See, e.g.*, CAL. CORP. CODE § 5231(a) (requiring a director to act “with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances”); FLA. STAT. ANN. § 617.0830(1)(b) (requiring a director to act “[w]ith the care an ordinarily prudent person in a like position would exercise under similar circumstances”); MASS. GEN. LAWS ANN. ch. 180, § 6C (requiring a director to act “with such care as an ordinarily prudent person in a like position with respect to a similar corporation organized under this chapter would

requires trustees to obey the terms of their trust.¹² Essentially extending this trust law requirement into charitable nonprofit corporate law, some commentators, joined by at least one court, recognize a third distinct fiduciary duty owed by fiduciaries¹³ of charitable nonprofit corporations: the duty of obedience.¹⁴

Other commentators prefer to articulate fiduciary obedience norms governing directors of charitable nonprofit corporations in terms of the duties of care and loyalty, which must be exercised in good faith.¹⁵ Indeed, the American Law

use under similar circumstances”); MICH. COMP. LAWS ANN. § 450.2541(1) (West 2012) (stating that a director must discharge her duties “with the degree of diligence, care, and skill which an ordinarily prudent person would exercise under similar circumstances in a like position”); N.Y. NOT-FOR-PROFIT CORP. LAW § 717(a) (McKinney 2003) (mandating that a director “perform his duties. . . in good faith and with that degree of care which an ordinarily prudent person in a like position would use under similar circumstances”); OHIO REV. CODE ANN. § 1702.30(B) (stating that a director must act “with the care that an ordinarily prudent person in a like position would use under similar circumstances”); 15 PA. CONS. STAT. ANN. § 5712(a) (requiring a director to exercise “reasonable inquiry, skill and diligence, as a person of ordinary prudence would use under similar circumstances”); TEX. BUS. ORGS. CODE ANN. § 22.221(a) (requiring a director to act “with ordinary care”).

11. The standards associated with the duty of care governing directors of charitable nonprofit corporations are similar to those found in traditional trust law’s duty of prudent administration, which governs fiduciaries of charitable trusts. *See* Gary, *Socially Responsible Investing*, *supra* note 8, at 117–19. Under the Restatement (Third) of Trusts, a trustee is required “to administer the trust as a prudent person would, in light of the purposes, terms, and other circumstances of the trust.” RESTATEMENT (THIRD) OF TRUSTS § 77(1). In administering the trust in compliance with this duty, the trustee generally must exercise “reasonable care, skill, and caution.” *Id.* § 77(2).

12. *See infra* text accompanying notes 75–76, 88.

13. A charity fiduciary is one who oversees or manages a charitable entity, including a trustee of a charitable trust, a director of a charitable corporation, or an officer of a charitable entity. PRINCIPLES OF THE LAW OF NONPROFIT ORGS. at § 300 cmt. a.

14. *See, e.g., In re Manhattan Eye, Ear & Throat Hosp. v. Spitzer*, 715 N.Y.S.2d 575, 595 (Sup. Ct. 1999) (explaining that the duty of obedience requires the board of directors to “seek to preserve its original mission”); VICTORIA B. BJORKLUND ET. AL., NEW YORK NONPROFIT LAW AND PRACTICE: WITH TAX ANALYSIS 413–14 (1997); DANIEL L. KURTZ, BOARD LIABILITY: GUIDE FOR NONPROFIT DIRECTORS 21 (1988) (“[T]he duty of obedience requires that a director act with fidelity, within the bounds of the law generally, to the organization’s ‘mission,’ as expressed in its charter and by-laws.”); Fishman, *supra* note 8, at 237–39 (stating that directors of charitable nonprofit corporations have a duty of obedience, which “mandates that the board refrain from transactions and activities that are ultra vires, that is, beyond the corporation’s powers and purposes as expressed in its certificate of incorporation” and continuing that “a nonprofit corporation and its directors and officers have the responsibility to comply with the law”); Palmiter, *supra* note 8, at 466 (“The duty of obedience has a . . . pedigree in the non-profit corporation. It is regularly mentioned along with the duties of care and loyalty.”). For analyses of the scope and purpose of the duty of obedience, *see generally* Rob Atkinson, *Obedience as the Foundation of Fiduciary Duty*, 34 J. CORP. L. 43, 47–54 (2008) (exploring the depth, breadth, and length of the duty of obedience and its development in Anglo-American jurisprudence).

15. *See, e.g.,* Goldschmid, *supra* note 8, at 641 (“[T]he analytical approach of this Article, consistent with for-profit case law, is to treat obedience to the bounds of the law and to the organization’s mission as special functions of directors and officers to which general duty of care standards apply.”); *see also* Manny, *supra* note 8, at 20 (“There is some question as to whether [the

Institute's Principles of the Law of Nonprofit Organizations (PLNO) expressly declines to recognize either a distinct duty of obedience or certain limitations on fiduciary behavior that the duty is understood to entail.¹⁶ Perhaps reflecting the divergence of opinion on the merits of various obedience norms, there is no consensus among commentators as to which view of the duty of obedience commands the greater scholarly imprimatur.¹⁷

However, deciding whether the law should articulate a distinct duty of obedience owed by all charity fiduciaries may be less important than identifying and analyzing the obedience norms that do, or should, govern charity fiduciaries—under whichever duty they may fall. The law's choice of obedience norms dictates how easily charity managers, such as the trustees of Deep Springs College, can adapt to their surroundings. It also largely determines the degree to which charity fiduciaries or state actors control the operations of charitable entities.

This Article explores whether and how the exercise of discretion by charity fiduciaries in recasting a charity's direction is, and should be, limited. Analyzing this basic issue raises additional, difficult inquiries: If the law does limit the ability of charity fiduciaries to determine the charitable paths of their entities, what standards govern the exercise of fiduciary discretion? To what extent does, and should, the law treat fiduciaries of charitable trusts dissimilarly from those who govern charitable nonprofit corporations? What role should governmental actors play in monitoring these decisions by charity managers? If governmental actors should assume some monitoring role, should their review of fiduciary decisions be *ex ante* or *ex post*? Which governmental actors should be involved? Can donors and other stakeholders sufficiently protect their interests absent a strong supervisory role by the government?

These questions are not simply esoteric enigmas designed to tickle the ears¹⁸ of legal scholars. As the Deep Springs community is well aware, these questions

duty of obedience] actually exists as a separate duty, or whether it is best described as an element of the duty of loyalty and the duty of care as applied to non-profit organizations.”). Cf. Lloyd Hitoshi Mayer & Brendan M. Wilson, *Regulating Charities in the Twenty-First Century: An Institutional Choice Analysis*, 85 CHI.-KENT L. REV. 479, 491 (2010) (observing that “there is general agreement that charity leaders owe their organizations two duties under state laws: care and loyalty” and acknowledging the debate as to whether a distinct duty of obedience exists).

16. PRINCIPLES OF THE LAW OF NONPROFIT ORGS § 300 cmt. g(3); see also MARION R. FREMONT-SMITH, GOVERNING NONPROFIT ORGANIZATIONS: FEDERAL AND STATE LAW AND REGULATION 226 (2004) (“To the extent the duty of obedience does not carry with it a duty to assure that the trust is meeting contemporaneous needs, it does not set forth an appropriate standard.”).

17. Compare Sugin, *supra* note 8, at 897–98 (stating that “the future of the duty of obedience is very much at risk” and that “[i]t is not surprising that the duty of obedience fails the popularity contest”), with Mayer & Wilson, *supra* note 15 (stating that “[t]here also appears to be an emerging consensus that a third duty, that of obedience, also applies” to charity fiduciaries).

18. The phrase alludes to 2 *Timothy* 4:3–4 (New American Standard) (“For the time will come when they will not endure sound doctrine; but wanting to have their ears tickled, they will

matter greatly. Moreover, these questions are especially timely, for the law of obedience norms governing fiduciaries of charitable corporations is unsettled and in great need of refinement.¹⁹ Even the law governing trustees of charitable trusts, which is comparatively stable and uniform, merits reassessment once the meaning and purposes of obedience norms are thoroughly examined.

To foster the development of the law governing charity fiduciaries, this Article presents a taxonomy of obedience norms,²⁰ a doctrinal analysis of these norms, and a policy discussion to help answer these questions. Part I explains the fundamental nature of obedience norms and articulates and illustrates the various types of obedience norms. Parts II and III discuss legal authorities supporting or rejecting various obedience norms as applied to trustees of charitable trusts and directors of charitable nonprofit corporations, respectively. Part IV this Article evaluates the policy considerations that may justify one or more obedience norms. Finally, by presenting an analytical series of questions, Part V explains how the law should develop in imposing, and declining to impose, obedience norms on charity fiduciaries.

I. OBEDIENCE NORMS EXPLAINED AND ILLUSTRATED

A. *The Basic Nature of Obedience Norms*

Fundamentally, an obedience norm simply requires a charity fiduciary, such as a director, trustee, or officer, to govern or manage her charity in compliance with some limitation or norm imposed on the charity's activity.²¹ For example, a charitable organization must not undertake an illegal activity.²² By implication, a charity fiduciary must govern so as not to cause her charity to act

accumulate for themselves teachers in accordance to their own desires, and will turn away their ears from the truth and will turn aside to myths.”).

19. See Atkinson, *supra* note 14, at 46, 97 (stating that legal authorities are “seriously divided” as to whether a strong form of the duty of obedience applies in the case of charitable corporations and characterizing the relevant law as “a muddle”); Fremont-Smith & Lever, *supra* note 8, at 717 (“In some states, the attorney general’s common law authority over healthcare conversions and conversion foundations is unclear, in which case legislation may indeed be needed to clarify the attorney general’s power.”); Greaney & Boozang, *supra* note 8, at 58–59 (opining that states should not employ a trust law approach to the management of charitable corporations and observing that “[m]ost state courts facing this issue today are doing so for the first time”); Harold L. Kaplan, Patrick S. Coffey, & Rosemary G. Feit, *The “Charitable Trust” Doctrine: Lessons and Aftermath of Banner Health*, AM. BANKR. INST. J., May 2004, at 3 (stating that “[t]he far-reaching impacts of the charitable-trust theory on the operation of nonprofit healthcare organizations . . . cannot be overstated” and noting that “the law remains in flux”); Manny, *supra* note 8, at 20 (describing the duty of obedience as “a rather nebulous duty to carry out the mission of the organization”).

20. The framework of obedience norms expounded upon in this Article appears in embryonic form in Johnny Rex Buckles, *The Federalization of Fiduciary Obedience Norms in Tax Laws Governing Charities: An Introduction to State Law Concepts and an Analysis of Their Implications for Federal Tax Law*, 4 EST. PLAN. & COMMUNITY PROP. L.J. 197 (2012).

21. Fishman, *supra* note 8, at 237.

22. See *infra* Parts II.A.2, II.B.2, & III.A.

illegally.²³ Similarly, a charitable trustee must administer her trust in accordance with the terms of the trust instrument,²⁴ and a director of a nonprofit corporation must govern in a manner that is consistent with the charity's articles of incorporation and bylaws.²⁵ In each case, the trustee or director must "obey" something: the law or the charity's governing instrument(s).²⁶

B. A Framework for Obedience Norms Explained and Illustrated

In order to better analyze the degree to which the law should subject charity fiduciaries to various obedience norms, it is helpful to identify those norms that the law definitely imposes, and those that some might think the law does or should impose, on charity fiduciaries.²⁷

1. The Legality Norm

The requirement that fiduciaries ensure that their charities operate lawfully is referred to as the "legality norm." The legality norm plainly applies to both charitable trusts²⁸ and charitable nonprofit corporations.²⁹

2. The Dynamic Charter Fidelity Norm

The dynamic charter fidelity norm requires "fiduciaries to ensure that a charity operates in accordance with its governing instrument" (such as a trust instrument or certificate of formation/articles of incorporation), including its purposes clause.³⁰ The charity's members, the fiduciaries themselves, or both acting together may amend the governing instrument.³¹ These groups may act under the terms of the proposed changes before receiving "ex ante substantive approval."³² Ex ante substantive approval refers to approval by a governmental

23. See *infra* text accompanying notes 80–81.

24. RESTATEMENT (THIRD) OF TRUSTS § 76(1) (2003).

25. See *infra* text accompanying notes 103–05.

26. See e.g., Greaney & Boozang, *supra* note 8, at 44 ("Broadly construed, the duty of obedience expresses the obligation of nonprofit directors to observe and advance the mission of the charitable corporation by adhering to its purposes, usually as set forth in the entity's articles of incorporation or bylaws. However, in the few instances in which it is specifically mentioned by courts, it has been invoked to indicate directors' responsibility to assure that their corporations obey the law and not stray from the dictates of the purposes expressed in their articles and bylaws."); Mayer & Wilson, *supra* note 15, at 493 ("The duty of obedience, whether treated as a separate duty or as part of the duties of care and loyalty, requires charity leaders to ensure the charity both obeys applicable laws and complies with the provisions of its governing documents, including its stated mission.").

27. While most of the concepts underlying these norms appear in statutes, case law, and legal commentary, the terminology in this section is largely original with the author.

28. See *infra* Parts II.A.2, II.B.2.

29. See *infra* Part III.A.

30. Buckles, *supra* note 20, at 203.

31. *Id.*

32. *Id.* at 203, 215.

actor who must evaluate a proposed amendment before it is deemed legally effective, according to legal criteria for determining the justifiability of the amendment.³³

Ex ante substantive approval is distinguishable from approval based solely on a charity's compliance with procedural rules for amending its governing instrument. For example, an entity may amend its charter under typical state nonprofit corporation laws if it follows certain procedures.³⁴ Although an amendment is generally not effective unless the entity observes the statutory procedures, the state does not normally undertake a substantive review of the proposed amendments under the typical statute.³⁵ In contrast, under the common law of charitable trusts, unless the trust instrument provides otherwise, deviations from the terms of trust typically require court approval.³⁶

3. *The Static Charter Fidelity Norm*

The “static charter fidelity norm” requires fiduciaries to “ensure that a charity operates in accordance with its governing instrument—as it was originally drafted and as it may be amended only with the [ex ante] substantive approval of a governmental actor.”³⁷ It is important to note that this is the *static* charter fidelity norm, thus emphasizing that charity fiduciaries cannot unilaterally deviate from the terms of their charter merely by following certain procedures. Rather, they may amend charter purposes and act in accordance with amended charter terms only if a governmental actor (typically a court) authorizes such action after substantively reviewing the justifiability of a proposed change to the charity's governing instrument.³⁸

The static charter fidelity norm typically governs charitable trusts.³⁹ Therefore, if a charitable trust is formed for the express purpose of treating people suffering from a particular disease, but medical advances render the charity's fulfillment of this purpose impossible or impracticable, the charity's trustees may petition a court in a cy pres proceeding to authorize the trust to

33. *Id.* at 215 n.100.

34. *See infra* text accompanying note 107.

35. *See* Buckles, *supra* note 20, at 215 n.100 (citing TEX. BUS. ORGS. CODE ANN. § 4.002(a) (West 2011) (conditioning the filing of instruments on whether or not the instrument complies with the statutory requirements)).

36. *See infra* Part II.B.2.

37. Buckles, *supra* note 20, at 203.

38. *See id.* at 203 n.28 (“Notwithstanding that this norm allows for amendments to a charity's governing instrument if a governmental actor approves them, it is appropriately described as ‘static’ charter fidelity. Acting alone, fiduciaries bound by this norm cannot cause the charity to deviate from the terms of its governing instrument. Thus, from the perspective of fiduciaries who desire to amend the governing instrument but cannot obtain the necessary governmental approval to do so, the governing instrument is ‘static.’”).

39. *See infra* Part II.B.2.

fulfill a different charitable purpose.⁴⁰ In such a case, the trustees are subject to the static charter fidelity norm because they are not authorized to alter the purposes of the trust without first petitioning a court.

4. *The Dynamic Mission Fidelity Norm*

The term “dynamic mission fidelity norm” reflects “a requirement that fiduciaries cause their charities to operate in accordance with the charities’ precise charitable mission(s) as the governing board expands, contracts, or otherwise alters the mission(s) from time to time.”⁴¹ In this context, “charitable mission” refers to the specific charitable objectives that a charity maintains in carrying out its customarily broader purposes articulated in the purposes clause of its governing instrument.⁴² For example, consider an entity organized for “charitable purposes,” including “the purpose of benefiting the community by providing health care and promoting the health” of residents of a certain geographic region. Assume that the entity’s board has resolved to create and operate a children’s hospital in furtherance of the entity’s charter purposes. Operation of the children’s hospital is the mission of the entity. Under the dynamic mission fidelity norm, the governing board is free to alter the mission of the entity over time (for example, by resolving to turn the children’s hospital into a general hospital), but the board must govern the entity so as to advance whatever mission is in place until the board has officially changed that mission.

5. *The Historic Mission Fidelity Norm*

As an alternative to advancing the dynamic mission fidelity norm, the law could require fiduciaries to ensure that “their charities [] operate in accordance with the charities’ precise historic missions, which may be far more limited than the purposes for which they are expressly organized under their governing instruments”—the “historic mission fidelity norm.”⁴³ Under this norm, deviating from the historic mission of the charity requires *ex ante* substantive approval from a governmental actor.⁴⁴ Thus, consider the example of the children’s hospital. If fiduciaries are bound by the historic mission fidelity norm, they may not turn the children’s hospital into a general hospital simply by resolving to do so. Rather, they must first seek approval from an appropriate state official or body (most likely a court) to change the entity’s mission, even

40. See *infra* Part II.B.2 (explaining that the doctrines of *cy pres* and equitable deviation permit charitable trustees to deviate from the terms of the charitable trust in certain circumstances, but that this deviation is conditioned on court approval).

41. Buckles, *supra* note 20, at 203–04.

42. *Id.* at 202. Distinguishing between a charity’s specific mission and its charter purposes is common. PRINCIPLES OF THE LAW OF NONPROFIT ORGS. § 320 cmt. e; DiPietro, *supra* note 8, at 121–25.

43. Buckles, *supra* note 20, at 203.

44. See *id.* at 223.

though the purposes articulated in the entity's charter are plainly broad enough to encompass operating a general hospital.

6. *The Charity Advancement Norm*

Perhaps the most basic obedience norm, upon which all others rest, is what this Article shall term the "charity advancement norm." As charity fiduciaries seek to forge a clear charitable path for their entities, their choices are determined in part by state law's imposition of charter fidelity and mission fidelity norms. Although there is some variance as to the specificity and mutability of charitable purposes vis-à-vis obedience norms, all of the norms require "that charity fiduciaries act so as to advance charitable purposes."⁴⁵ Each norm discussed requires fiduciaries to "drive" charities in a "general charitable direction."⁴⁶ Consequently, a constitutive norm underlying the others may be called the "charity advancement norm."

The charity advancement norm implies a restraint, which prohibits charity fiduciaries from primarily advancing a *non-charitable* purpose.⁴⁷ The restraint is simply the negative corollary of the norm itself. The negative corollary of the charity advancement norm, like the norm proper, is constitutive of other obedience norms. A course of action by charity fiduciaries that violates the negative corollary of the charity advancement norm would generally also betray the other obedience norms identified in this Article, such as the dynamic charter fidelity, static charter fidelity, historic mission fidelity, and dynamic mission fidelity norms.⁴⁸ Furthermore, the negative corollary of the charity advancement norm and the legality norm reinforce one another, because operating illegally is generally inconsistent with advancing only charitable purposes.⁴⁹

45. *Id.* at 212.

46. *Id.* There are two elements of the charity advancement norm. *Id.* at 212 n.90. First, charity fiduciaries must "cause the charity to advance a purpose" (the element of "propelling"). *Id.* Second, charity fiduciaries must ensure that the purpose advanced by the charity is, in fact, charitable (the element of "steering"). *Id.*

47. *Id.* *Cf.* Dana Brakman Reiser, *Charity Law's Essentials*, 86 NOTRE DAME L. REV. 1, 2 (2011) ("To be a charity, an organization must pursue a charitable mission as its dominant and overriding purpose.").

48. Buckles, *supra* note 20, at 213. However, truly minimal advancement of a non-charitable purpose does not necessarily negate adherence to obedience norms. *Cf.* Treas. Reg. § 1.501(c)(3)-1(c)(1) (2008) (stating that an organization is not operated exclusively for tax-exempt purposes under § 501(c)(3) of the Internal Revenue Code "if more than an insubstantial part of its activities is not in furtherance of an exempt purpose").

49. Buckles, *supra* note 20, at 213.

C. Contexts for Applying Obedience Norms

Obedience norms apply in a variety of circumstances. The following discussion identifies several of these contexts.⁵⁰

1. Daily Operations

Obedience norms limit the options available to fiduciaries as they oversee the charity's routine operations.⁵¹ For example, the legality norm requires fiduciaries to manage the charity so as to ensure that it operates lawfully.⁵² Similarly, charter fidelity norms constrain charitable choices contemplated by charity managers, and mission fidelity norms prevent a charity from straying from a pre-approved charitable pathway as it conducts daily operations.

Certain obedience norms not only preclude charity managers from advancing illegitimate purposes, but also require them to act positively.⁵³ For example, the charity advancement norm requires fiduciaries to oversee the charity's operations to ensure that it indeed serves a charitable purpose.⁵⁴ The charter fidelity norms can be understood to impose a duty on charity managers to manage their charity so that it actually fulfills the purposes set forth in its charter.⁵⁵ Similarly, the mission fidelity norms may be seen as requiring charity fiduciaries to ensure that their charity carries out its specific charitable mission.⁵⁶

2. Formal Amendments to Charter

A state's choice between the two charter fidelity norms determines the ease with which a charity can amend its governing instrument.⁵⁷ Under the dynamic charter fidelity norm, a charity can amend its governing instrument, including its purposes clause, much more easily than a charity constrained by the static charter fidelity norm. Under the latter, fiduciaries who wish to change the terms of the charity's governing instrument must first receive permission from a governmental actor, such as a court—permission that may be granted only after the governmental actor has reviewed the justifiability of the change. The

50. These examples are illustrative, not exhaustive. Other contexts requiring a choice of obedience norms include dispositions of a significant portion of an institution's assets, and corporate combinations, such as mergers.

51. See Buckles, *supra* note 20, at 212 (explaining ways in which the various norms might constrain directors of a charity).

52. *Id.* at 203.

53. See *id.* at 212–13 (noting that several norms share the requirement that charity fiduciaries must “propel” the charity “in a general charitable direction”).

54. See *supra* Part I.B.6.

55. See, e.g., *Oberly v. Kirby*, 592 A.2d 445, 468 n.17 (Del. 1991) (referring to “the special duty of the fiduciaries of a charitable corporation to protect and advance its charitable purpose”).

56. See, e.g., Sugin, *supra* note 8, at 904–05 (advocating for the adoption of a legal requirement that directors seek to follow and carry out the charitable mission of the organization, even when contrary to the original statements in the organization's charter).

57. For a discussion of statutory law specifically addressing this issue, see *infra* Part III.B.2.

dynamic charter fidelity norm, in contrast, allows fiduciaries to amend the charity's charter without first submitting the change to state actors for substantive review.⁵⁸

3. Use of Funds to Further Post-Amendment Charter Purposes or a New Mission

Changes to a charity's purposes clause and modifications to a charity's mission present a very interesting legal issue: May funds held by the charity prior to the change in charter purposes (or mission) be used to further the charity's new charter purposes (or new mission)?⁵⁹ To articulate this issue is to recognize that the choice of charter fidelity norm, as well as the choice of mission fidelity norm, affects much more than merely the method by which charity fiduciaries can initiate changes to the charity's formal purposes and mission.

To illustrate, assume that the dynamic charter fidelity norm governs formal amendments to a charity's governing instrument. Under this norm, as long as the charity's governing board follows the procedures set forth in state statutory law, the board is free to alter the express purposes for which the charity is organized. However, that the dynamic charter fidelity norm governs the charity's formal ability to amend its charter does not necessarily mandate that the dynamic charter fidelity norm governs the charity's ability to use pre-amendment assets to further post-amendment purposes. Conceivably, state law could instead apply the static charter fidelity norm to the post-charter-amendment use of assets held before the charter amendment.⁶⁰ Similarly, a legal question arises as to whether the charity can devote assets held prior to the change in mission to advance its new mission, even if a formal charter amendment is not necessary when the governing board changes the charity's mission. The charity would not be free to do so if the historic mission fidelity norm, rather than the dynamic mission fidelity norm, governs the use of assets held prior to the change in mission.⁶¹

58. See *supra* Part I.B.2. As observed previously, state laws imposing merely procedural requirements for amending a charter, such as those mandating advance notice of proposed amendments to those with voting privileges and those requiring that resolutions adopting amendments be filed with state agencies, involve no substantive review by state actors and are therefore consistent with the dynamic charter fidelity norm. *Id.*

59. See *infra* Part III.B.3. (providing a discussion of legal authorities specifically addressing this issue).

60. See *e.g.*, *Att'y Gen. v. Hahnemann Hosp.*, 494 N.E.2d 1011, 1021 (Mass. 1986) (applying the dynamic charter fidelity norm to the organization's amendment to its charter but strongly suggesting in dicta that the static charter fidelity norm should apply to the post-charter-amendment use of the assets the organization held before the amendment to the charter).

61. See *supra* Part I.B.5. (explaining that, under the historic mission fidelity norm, deviating from the historic mission of the charity requires *ex ante* substantive approval from a governmental actor).

4. *Distributions in Dissolution and Liquidation of a Charity*

A related issue is whether a charity seeking to dissolve itself may, pursuant to a plan of dissolution, transfer its assets to another charity with a mission different from that in its own charter.⁶² If the state statute governing distributions in dissolution expressly requires the dissolving entity to transfer its assets to other charities with purposes similar to the longstanding express purposes of the dissolving entity,⁶³ the statute at least partially embraces the static charter fidelity norm. The transferee must devote assets received from the dissolving entity in accordance with the transferee's charter—one that sets forth purposes similar to those of the dissolving entity's charter. In effect, because the two entities have similar charter purposes, such a state statute requires vicarious fidelity to the dissolved entity's charter.

If, however, the state statute does not explicitly require a dissolving entity to distribute assets to only charitable transferees with similar purposes,⁶⁴ the state courts must decide whether to employ common law trust concepts to compel such a result. To empower directors to authorize distributions in dissolution to a charity with purposes dissimilar to those of the dissolving charity effectively enables directors to select new charter terms that will govern distributed assets. Hence, directors with such authority are functioning under the dynamic charter fidelity norm. In contrast, if the courts require the dissolving entity to distribute assets to a charity with a similar purpose, the courts, in part, embrace the static charter fidelity norm in the context of dissolution and liquidation.⁶⁵ Similarly, if courts specifically require the transferee entity to operate similarly to the liquidating entity, the court embraces the historic mission fidelity norm.

D. *Co-Existence of Obedience Norms*

Some of these obedience norms can co-exist together, while others are incompatible.⁶⁶ The legality norm is consistent to some degree with every other norm, although it establishes boundaries for a charity's express charter purposes and mission. The dynamic charter fidelity norm and the static charter fidelity norm are mutually exclusive in any single context, as are the historic mission fidelity norm and the dynamic mission fidelity norm.

However, to embrace one of the charter norms to the exclusion of the other does not necessarily require one to adopt its most analogous mission fidelity norm. Thus, theoretically, a state that has adopted the static charter fidelity norm need not necessarily adopt the historic mission fidelity norm. A charity's

62. See *infra* Part III.B.4. (discussing case law specifically addressing this issue).

63. See, e.g., N.Y. NOT-FOR-PROFIT CORP. LAW § 1002-a(c)(1) (McKinney 2013) (requiring that corporate assets be transferred to an organization “engaged in activities substantially similar to those of the dissolved corporation”).

64. See, e.g., TEX. BUS. ORGS. CODE ANN. § 22.304(a)(2) (West 2012).

65. Buckles, *supra* note 20, at 208–09.

66. See Buckles, *supra* note 20, at 212.

proposed change in mission may be quite consistent with broadly-phrased charter purposes. The static charter fidelity norm limits the range of options available to directors seeking to alter a charity's mission, but it does not literally compel adherence to any specific mission.⁶⁷ In contrast, to embrace the dynamic charter fidelity norm in one context virtually requires rejection of the historic mission fidelity norm in the same context. For example, if directors are duty-bound to follow the charity's historic mission after a charter amendment to grant them formal authority to amend general charter purposes seems rather pointless.

Finally, norms that are mutually exclusive in the same context are not necessarily mutually exclusive when applied in different contexts. Thus, one theoretically could embrace the dynamic charter fidelity norm in the context of formally approving charter amendments, but favor the static charter fidelity norm as applied to the post-amendment use of funds held by the charity both before and after the amendment, or as applied to distributions in liquidation of the charity.

II. OBEDIENCE NORMS GOVERNING TRUSTEES OF CHARITABLE TRUSTS

A. *Trust Law in General*

From the perspective of trustees, the law of private trusts largely subsumes the norm of static charter fidelity, circumscribed by the legality norm.

1. *The Charter Fidelity Norm Under General Trust Law*

Under the Restatement (Third) of Trusts, a trustee "has a duty to administer the trust, diligently and in good faith, in accordance with the terms of trust and applicable law."⁶⁸ The official Comment to the Restatement refers to the duty as "[t]he normal duty of a trustee to obey the terms of trust."⁶⁹ Although a trust can often be amended with the consent of all beneficiaries (or, in some cases, with the consent of the beneficiaries and the settlor),⁷⁰ a trustee who believes an amendment is prudent generally may not unilaterally amend the trust instrument absent explicit authority in the trust instrument to do so.⁷¹ A petition for judicial modification of the trust must be filed, and relief is available only in limited circumstances.⁷² To require a trustee to obey the terms of trust is, of course, to

67. *Id.* In general, "[t]his conclusion holds unless the charter purposes are so detailed that they effectively define the specific mission of the charity." *Id.* at 212 n.88.

68. RESTATEMENT (THIRD) OF TRUSTS § 76(1) (2007).

69. *Id.* § 76, cmt. b(1).

70. *See, e.g., id.* § 65(1) (permitting modification of the trust with the consent of all beneficiaries).

71. *See, e.g., id.* § 64(1) (allowing a trustee to modify the terms of trust only as granted by the trust itself).

72. *See id.* § 66(2) (noting that the trustee must petition the court to deviate from or modify the terms of trust); *see also, e.g.,* IND. CODE ANN. § 30-4-3-26(a) (LexisNexis 2011); PA. CONS. STAT. ANN. § 7740.2 (West 2012); TEX. PROP. CODE ANN. § 112.054 (West 2007).

require “charter fidelity.” Further, to permit trustees to act contrary to those terms only by petitioning a court to authorize a trust amendment is to embrace the static charter fidelity norm.

2. *The Legality Norm*

The law of trusts also embraces the legality norm by invalidating trust terms that are illegal or contrary to public policy.⁷³ Moreover, a trustee is not under a duty to comply with a trust provision that is unlawful or contrary to public policy; indeed, the trustee is generally under a duty *not* to comply with such a provision.⁷⁴

B. *Charitable Trust Law*

1. *The Charity Advancement Norm*

Trust law permits the creation of charitable trusts, which, unlike private trusts, are not formed primarily to benefit identified or ascertainable beneficiaries.⁷⁵ A trust’s purpose is considered charitable “if its accomplishment is of such social interest or benefit to the community as to justify permitting the property to be devoted to the purpose in perpetuity and to justify the various other special privileges that are typically allowed to charitable trusts.”⁷⁶ A trust can be “charitable” even if it does not designate a particular charitable purpose or mode for achieving charitable purposes.⁷⁷ Thus, a trust organized simply for “charitable purposes” is a charitable trust.⁷⁸

Almost tautologically, to require a trustee to administer a “charitable” trust according to its terms is to implement the charity advancement norm. Charitable trusts are accorded special treatment in virtue of their “charitable purposes” expressed in the terms of trust, according to which trustees must administer their trusts.⁷⁹ Therefore, to require a trustee to administer a charitable trust according to its terms is to compel adherence to the charity advancement norm.

73. See, e.g., RESTATEMENT (THIRD) OF TRUSTS § 29(a) (stating that a trust or trust provision is invalid if “its purpose is unlawful or its performance calls for the commission of a criminal or tortious act”); RESTATEMENT (SECOND) OF TRUSTS § 60 (1959) (“An intended trust or a provision in the terms of a trust is invalid if illegal.”); *id.* § 61 (“An intended trust or a provision in the terms of trust is invalid if the performance of the trust or of the provision involves the commission of a criminal or tortious act by the trustee.”).

74. RESTATEMENT (THIRD) OF TRUSTS § 72 cmts. a–b.

75. See *id.* §§27–28 (noting that trusts can be formed either for charitable or private purposes, and providing a list of acceptable charitable purposes).

76. *Id.* § 28 cmt. a.

77. *Id.*

78. *Id.*

79. See *id.* (explaining that charitable trusts are “favored” in various ways).

2. *Cy Pres, Equitable Deviation, the Legality Norm, and the Static Charter Fidelity Norm*

Charitable trusts are also governed by the legality and static charter fidelity norms. The terms of charitable trusts, like other trusts, must not be unlawful,⁸⁰ and their trustees generally must obey lawful trust terms.⁸¹ The law of charitable trusts also embraces both the legality and static charter fidelity norms through the doctrines of cy pres and equitable deviation. The doctrine of cy pres allows trustees to deviate from the dispositive terms of a charitable trust only in limited circumstances, and only with advance judicial approval.⁸² Under the traditional doctrine of cy pres, a court may direct charity fiduciaries to apply charitable trust funds to purposes similar to the original trust purposes if accomplishing the original purposes becomes impossible, impracticable, or illegal, as long as the transferor of the funds has manifested an intent to devote the funds to charitable purposes more general than the frustrated specific charitable purpose.⁸³ The Restatement (Third) of Trusts and the Uniform Trust Code generally follows the traditional doctrine of cy pres, but adds wastefulness to the grounds for applying the doctrine and presumes that a donor possesses general charitable intent.⁸⁴

80. *Id.* § 28 cmt. f.

81. *See id.* § 76 (imposing a general duty on all trustees to administer the trust according to its terms and the law); *see also id.* § 76 cmt. b(1) (stating that this duty applies when the terms of trust have been reformed or modified under section 67 of the Restatement, which applies only to charitable trusts).

82. *See id.* § 67 (stating that if a charitable trust “becomes unlawful, impossible or impractical to carry out . . . or to the extent it is or becomes wasteful to apply all of the property to the designated purpose . . . then a court will direct application of [trust] property or appropriate portion thereof to a charitable purpose that reasonably approximates the designated purpose”); AUSTIN W. SCOTT ET AL., 6 SCOTT AND ASCHER ON TRUSTS § 39.5.2 (5th ed. 2009) (stating that cy pres may be applied when it “is unlawful, impossible, impracticable, or wasteful to carry out” the settlor’s particular charitable purposes).

83. *Sharpless v. Medford Monthly Meeting of the Religious Soc’y of Friends*, 548 A.2d 1157, 1160 (N.J. Super. Ct. App. Div. 1988); RESTATEMENT (SECOND) OF TRUSTS § 399 (1959). *Cf.* RONALD CHESTER, GEORGE GLEASON BOGERT & GEORGE TAYLOR BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 438 (3d ed. 2005) (stating that the doctrine applies when, in relevant part, furthering the charitable use intended by the donor “is or becomes impossible or impractical”); *id.* § 436 (“The courts that have applied judicial cy pres to a charitable trust have usually required that the settlor have exhibited a general or broad charitable intent in addition to the particular purpose served by that trust.”); SCOTT, *supra* note 82 (stating that a court may apply cy pres when it “is unlawful, impossible, impracticable, or wasteful” to fulfill the settlor’s particular charitable purposes). Some sources articulate the doctrine as involving three prongs: (1) the settlor gratuitously transferred property in trust for a designated charitable purpose; (2) carrying out the designated purposes of the gift is, or becomes, impossible, impracticable, or illegal; and (3) the trustor manifested a general intention to devote the gifted property to charitable purposes. *See* 15 AM. JUR. 2D *Charities* § 146 (2011). *See generally* SCOTT, *supra* note 82, § 39.5 (discussing the cy pres doctrine).

84. *See* RESTATEMENT (THIRD) OF TRUSTS § 67 & cmt. b (2003) (describing the modern rule as “displacing the traditional quest for a settlor’s ‘general charitable intent’ when the trust” is silent on the issue); UNIF. TRUST CODE § 413 & cmt. (2010) (explaining that modern doctrine differs from the traditional doctrine in that it presumes that the donor possessed a general charitable intent).

Closely related to the doctrine of *cy pres* is the doctrine of deviation (or “equitable deviation”). This latter doctrine empowers a court to direct a trustee of a charitable trust to deviate from the administrative terms of a trust if compliance with the original terms is impossible or illegal, or if compliance with the terms of trust would substantially impede the accomplishment of trust purposes on account of circumstances that the settlor did not foresee.⁸⁵

In summary, unless the original charitable purposes fail on account of illegality, impossibility, impracticability, or wastefulness, trustees of charitable trusts must obey the express charitable purposes for which the settlor created the trust. Further, if the trustees believe that the grounds for applying *cy pres* exist, they must petition a court before straying from the express terms of trust. A similar rule applies if trustees wish to depart from the administrative terms of trust. The default rules governing charitable trusts thereby adopt a strong form of the static charter fidelity norm, as limited by the legality norm.

3. *Mission Fidelity*

The common law of charitable trusts does not appear to articulate any mission fidelity norm that is distinct from static charter fidelity. Of course, the trustees of a charitable trust are generally bound by the terms of trust, as expressed in the trust instrument. A charitable trust may be drafted so as to articulate a very specific charitable purpose, one that might qualify as a charitable “mission,” as the term is commonly employed. A trustee desiring to alter that specific mission must petition a court in *cy pres* proceedings and establish the grounds for applying the doctrine.⁸⁶ The salient fact is that any such action is necessary only when the charitable “mission” is articulated in the trust instrument. The doctrine of *cy pres* applies only when “property is placed in trust to be applied to a designated charitable purpose.”⁸⁷ If no “designated” charitable purpose fails, there is no basis for petitioning a court to amend the terms of the charitable trust. Accordingly, the common law doctrine of *cy pres* does not contemplate judicial scrutiny of mere changes in charitable mission that fall within the scope of broad charitable purposes articulated in the trust instrument.

85. See RESTATEMENT (THIRD) OF TRUSTS § 66(1) & cmt. c (expanding the doctrine to authorize deviation from terms that are not merely administrative); see, e.g., *MacCurdy-Salisbury Educ. Fund v. Killian*, 309 A.2d 11, 13–14 (Conn. Super. Ct. 1973) (applying the doctrine of deviation to minimize adverse federal excise tax consequences of accumulating trust income).

86. See *supra* Part II.B.2.

87. RESTATEMENT (THIRD) OF TRUSTS § 67 (2003).

III. OBEDIENCE NORMS GOVERNING DIRECTORS OF CHARITABLE NONPROFIT CORPORATIONS

The typical nonprofit corporation statute imposes no express “duty of obedience” on directors of charitable nonprofit corporations.⁸⁸ Nonetheless, state nonprofit laws embrace a variety of obedience norms.

A. *The Legality Norm*

Nonprofit corporations, like other entities, are typically required to act in accordance with the law.⁸⁹ Fiduciaries who deliberately cause an entity to act unlawfully would presumably breach their statutory fiduciary duties.⁹⁰ Consequently, state corporation laws embrace the legality norm.

B. *Charter Fidelity Norms*

1. *In General*

State nonprofit corporation laws also adopt norms of charter fidelity. Directors of a nonprofit charitable corporation must not cause the entity they govern to act contrary to its corporate purposes.⁹¹ Accordingly, under the 1987

88. See, e.g., CAL. CORP. CODE § 5231(a) (West 2013) (setting forth fiduciary standards governing directors); FLA. STAT. ANN. § 617.0830 (1) (West 2007) (same); MASS. GEN. LAWS ANN. ch. 180, § 6C (West 2010) (same); MICH. COMP. LAWS ANN. § 450.2541 (West 2012) (same); OHIO REV. CODE ANN. § 1702.30(B) (LexisNexis 2009) (same); 15 PA. CONS. STAT. ANN. § 5712(a) (West 1995) (same).

89. See, e.g., TEX. BUS. ORGS. CODE ANN. § 2.003(1)(A) (West 2012) (stating that a domestic entity may not take part in an “activity that is expressly unlawful or prohibited by a law of this state”). Cf. CAL. CORP. CODE § 7111 (West 2013) (stating that a corporation may be formed “for any lawful purpose”); VA. CODE ANN. § 13.1-825 (2011) (stating that a Virginia nonstock corporation generally “has the purpose of engaging in any lawful activity”).

90. See TEX. BUS. ORGS. CODE ANN. § 2.113(a) (West 2012) (stating that the statutory section specifying a domestic entity’s powers “does not authorize . . . a managerial official of a domestic entity to exercise a power in a manner inconsistent with a limitation on the purposes or powers of the entity contained in . . . this code, or other law of this state”); *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 67 (Del. 2006) (“A failure to act in good faith may be shown . . . where the fiduciary acts with the intent to violate applicable positive law. . . .”); *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959, 970 (Del. Ch. 1996) (stating, in the context of a dispute involving a for-profit corporation, that “a director’s obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists, and that failure to do so under some circumstances may, in theory at least, render a director liable for losses caused by non-compliance with applicable legal standards”).

91. Cf., e.g., TEX. BUS. ORGS. CODE ANN. § 2.113(a) (2012) (stating that the statutory section specifying a domestic entity’s powers “does not authorize . . . a managerial official of a domestic entity to exercise a power in a manner inconsistent with a limitation on the purposes or powers of the entity contained in its governing documents”). Thus, in Texas, the state attorney general may sue to enjoin any such action, and a corporation may sue a director who causes a corporation to act outside of its corporate purposes. *Id.* § 20.002(c)(2), (c)(3)(B). Ohio law provides similarly. See OHIO REV. CODE ANN. § 1702.12(I)(1)(a)–(b) (2013) (permitting the state to bring an action against the corporation, or permitting the corporation to bring suit against a member, officer, or director).

Revised Model Nonprofit Corporation Act (RMNCA) and the more recent Model Nonprofit Corporation Act, Third Edition (MNCA Third), certain lawsuits are contemplated when a corporation is alleged to have acted outside of its powers.⁹² Therefore, both model acts implicitly require directors to obey their corporate charters.⁹³

Some authorities have also recognized a positive duty imposed on directors to advance the charitable purposes of the corporations they oversee.⁹⁴ A question that arises is whether this duty is better expressed in terms of the dynamic charter fidelity norm or the static charter fidelity norm.

2. The Dynamic Charter Fidelity Norm Predominates in the Context of Formal Adoption of Charter Amendments

State nonprofit corporation statutes typically permit amendments to corporate charters, including purposes clauses, as long as the entity follows the proper internal procedures.⁹⁵ In other words, the typical nonprofit corporation statute does not forbid members or directors from changing the historic charter purposes of an incorporated charity.⁹⁶ Thus, state nonprofit corporation statutes commonly appear to embrace the dynamic charter fidelity norm as applied to the formal requirements for amending a corporate charter.⁹⁷

Like many states, the PLNO embraces the dynamic charter fidelity norm. Under the PLNO, a charity fiduciary must cause the charity to obey the law and charter purposes, but fiduciaries are free to amend the entity's charter purposes

92. See, e.g., REVISED MODEL NONPROFIT CORP. ACT § 3.04; MODEL NONPROFIT CORP. ACT 3d § 3.04.

93. See Fishman, *supra* note 8, at 237 (explaining that directors must abide by the organization's governing documents).

94. See, e.g., OHIO REV. CODE ANN. § 1702.30(E) (“[A] director shall consider the purposes of the corporation”); *Oberly v. Kirby*, 592 A.2d 445, 468 n.17 (Del. 1991) (referring to “the special duty of the fiduciaries of a charitable corporation to protect and advance its charitable purpose”); *id.* at 472–73 (stating that fiduciaries of a charitable corporation “have a special duty to advance its charitable goals”).

95. See, e.g., CAL. CORP. CODE §§ 5810–5817 (West 2013) (specifying procedures to amend a charitable nonprofit's articles of incorporation); TEX. BUS. ORGS. CODE ANN. § 22.105 (specifying procedures for amending the certificate of formation for a corporation with members who have voting rights); *id.* § 22.106 (specifying procedures for amending the certificate of formation for a corporation whose management is vested in its members); *id.* § 22.107 (specifying procedures for amending the certificate of formation by the board of directors).

96. See Katz, *supra* note 8, at 696–97 (noting that the boards of charitable corporations have broad authority to change the corporation's purpose).

97. New York law is an exception. In New York, amendments to the purposes clause in a charity's corporate charter require judicial approval. See, e.g., N.Y. NOT-FOR-PROFIT CORP. LAW § 804(a)(ii) (McKinney 2013) (requiring further that the state attorney general receive ten days' written notice of an application for judicial approval of the charter amendment). Accordingly, New York implements the static charter fidelity norm.

in accordance with the procedures set forth by state laws governing amendments.⁹⁸ The comments to the PLNO state:

Some commentators place the obligation to obey the law and the organizational documents and policies under a third duty unique to charity fiduciaries—the ‘duty of obedience.’ Substantively, to these commentators, such a duty embraces a faithfulness to the purposes of the charity. These Principles, however, do not employ the terminology of a duty of obedience. While the members of the governing board must adhere to the organizational documents, they also have the obligation to keep the purpose of the charity current and useful. Accordingly, the board must amend the stated purposes when necessary and appropriate to do so, in accordance with the law and the existing organizational documents.⁹⁹

The RMNCA and the MNCA Third likewise permit a nonprofit corporation to amend its articles of incorporation by following certain procedures, without needing to petition a court.¹⁰⁰

3. What Charter Fidelity Norm Governs the Use of Assets Held Before and After a Charter Amendment?

An issue that tests the bounds of obedience norms is whether a charity may use assets held prior to a charter amendment—as well as substitutes or replacements for those assets—to fulfill post-amendment purposes. A state law prohibiting a charity from using its assets (and replacements thereof) held prior to the charter amendment to advance post-amendment purposes implements the static charter fidelity norm as to the management of pre-amendment funds and their substitutes.¹⁰¹

a. The PLNO and Model Nonprofit Corporation Acts

Legal reform efforts have produced mixed results in offering guidance on this issue. The PLNO features the greatest clarity, providing that, if charter purposes are amended, general, unrestricted funds held by the charity may be used to advance post-amendment purposes.¹⁰² The PLNO thereby embraces the dynamic charter fidelity norm in this context.

Model nonprofit corporate statutes are less definitive. Under the 1987 RMNCA and the more recent MNCA 3rd ed., “obedience” to the corporate

98. PRINCIPLES OF THE LAW OF NONPROFIT ORGS. § 300 cmt. g(3).

99. *Id.*

100. See REVISED MODEL NONPROFIT CORP. ACT §§ 10.01–.31 (explaining the amendment process and requirements); MODEL NONPROFIT CORP. ACT 3d §§ 10.01–10.09 (same).

101. Even if the charity can formally amend its charter purposes without first receiving governmental approval of the amendment, a state law that requires charity managers to employ funds held prior to the charter amendment to fulfill pre-amendment purposes effectively embraces the static charter fidelity norm as to the management of those assets.

102. PRINCIPLES OF THE LAW OF NONPROFIT ORGS. § 245 (Preliminary Draft No. 3, 2005).

charter does not foreclose amendments to charter purposes.¹⁰³ However, each act does contemplate limitations on a corporation's ability to redeploy funds from their originally intended uses following an amendment of charter purposes.¹⁰⁴ The 1987 RMNCA states that a charter amendment does not affect "any requirement or limitation imposed upon the corporation or any property held by it by virtue of any trust upon which such property is held by the corporation."¹⁰⁵ As discussed below, some courts characterize donated assets held by a charitable corporation as funds impressed with a trust.¹⁰⁶ The 1987 RMNCA does not explicitly state whether an otherwise unrestricted gift to a charitable corporation is impressed with a charitable trust governed by its charter purposes at the time of the gift,¹⁰⁷ and the MNCA Third is arguably even more ambiguous.¹⁰⁸

b. Case Law Supporting the Static Charter Fidelity Norm

Contrary to the rule embraced by the PLNO, some cases implement the static charter fidelity norm as applied to the post-amendment use of funds held before and after a charter amendment. An illustrative case is *In re Manhattan Eye, Ear & Throat Hospital v. Spitzer*, in which a charitable corporation operating an acute care specialty teaching hospital proposed to sell its facility and use the

103. See REVISED MODEL NONPROFIT CORP. ACT §§ 10.01–.31; MODEL NONPROFIT CORP. ACT 3d §§ 10.01–10.09.

104. See REVISED MODEL NONPROFIT CORP. ACT § 10.08; MODEL NONPROFIT CORP. ACT 3d § 10.09.

105. REVISED MODEL NONPROFIT CORP. ACT § 10.08. *Cf.* CAL. CORP. CODE § 5820(a) (West 1990) ("Amendment of the articles of a corporation, pursuant to this chapter, does not, of itself, abrogate any requirement or limitation imposed upon the corporation, or any property held by it, by virtue of the trust under which such property is held by the corporation.").

106. See *infra* text accompanying notes 150–65. *But cf.* RESTATEMENT (THIRD) OF TRUSTS § 28 cmt. a (2007) (stating that a gift to a charitable corporation for its general purposes does not create a trust).

107. One commentator argues that the RMNCA "nowhere requires the use of general funds for pre-amendment purposes only." Katz, *supra* note 8, at 697. This reading of the RMNCA assumes that charter purposes do not impress general corporate funds with a "trust" within the meaning of section 10.08. Another commentator takes a contrary view of the RMNCA. See Iris J. Goodwin, *Donor Standing to Enforce Charitable Gifts: Civil Society vs. Donor Empowerment*, 58 VAND. L. REV. 1093, 1135 (2005) ("Although some states may accord directors a measure of autonomy in interpreting the charity's mission, the commissioners who drafted the Revised Model Nonprofit Corporation Act were ultimately uncomfortable with the idea of allowing a corporate charity to alter its purposes without applying to court for cy pres relief. . . ."). The comments to the RMNCA are ambiguous. See, e.g., REVISED MODEL NONPROFIT CORP. ACT § 2.02 cmt. 3(a) ("By irrevocably dedicating assets when such dedication is not required, the incorporators may inadvertently impress the assets of a corporation with unintended restrictions and obligations."); see also Greaney & Boozang, *supra* note 8, at 58 ("[T]he Act suggests the possibility that the corporation, as distinct from the director, may continue to be subject to state common law that applies trust rules to the property held by the nonprofit corporation.") (citing RMNCA § 8.30 cmt. 1).

108. See Buckles, *supra* note 20, at 210 (discussing whether the static charter fidelity norm applies under the MNCA Third, and determining that the statute "punts on the issue").

proceeds to support free-standing diagnostic and treatment centers in poor neighborhoods.¹⁰⁹ Realizing that this course of action would require an amendment to the hospital's certificate of incorporation, the hospital's governing board authorized, but did not formally adopt, the required amendment.¹¹⁰ The proposed sale of substantially all of the hospital's assets required judicial approval under state law.¹¹¹ The relevant statute required the hospital to establish that "the consideration and the terms of the [transaction] are fair and reasonable to the corporation, and that the purposes of the corporation . . . will be promoted thereby."¹¹²

The court concluded that the charity failed to satisfy both prongs of the statutory test.¹¹³ Under the first prong, the hospital's board disregarded the value of the hospital's ongoing operations and its name.¹¹⁴ Under the second prong, the board proposed "a fundamental change" and sought to devote corporate assets to "a new and fundamentally different corporate purpose."¹¹⁵

In prefacing its analysis of each statutory prong, the court embraced the duty of obedience in no uncertain terms¹¹⁶ and interpreted the statute through the lens of the duty of obedience.¹¹⁷ Recognizing that, under some circumstances, a board may properly abandon "the organization's mission by selling its assets and then undertaking a new mission,"¹¹⁸ the court opined that one should direct attention to "the duty of obedience, which mandates that a Board, in the first instance, seek to preserve its original mission."¹¹⁹ The court further explained that initiating "a course of conduct which turns it away from the charity's central and well-understood mission should be a carefully chosen option of last resort."¹²⁰ Otherwise, in the face of financial difficulties, a board might choose to sell the nonprofit's assets and modify its mission, "rather than taking all

109. 715 N.Y.S.2d 575, 577–78 (N.Y. Sup. Ct. 1999).

110. *Id.* at 584.

111. *See* N.Y. NOT-FOR-PROFIT CORP. LAW § 511(a) (McKinney 2005).

112. *Id.* § 511(a)(6).

113. *Manhattan Eye*, 715 N.Y.S.2d at 597.

114. *Id.* at 594.

115. *Id.* at 594–95.

116. *See id.* at 593 ("It is axiomatic that the Board of Directors is charged with the duty to ensure that the mission of the charitable corporation is carried out. This duty has been referred to as the 'duty of obedience.' It requires the director of a not-for-profit corporation to 'be faithful to the purposes and goals of the organization,' since '[u]nlike business corporations, whose ultimate objective is to make money, nonprofit corporations are defined by their specific objectives: perpetuation of particular activities are central to the *raison d'être* of the organization.' . . . [T]he duty of obedience, perforce, must inform the question of whether a proposed transaction to sell all or substantially all of a charity's assets promotes the purposes of the charitable corporation when analyzed under section 511.").

117. *Id.*

118. *Id.* at 595.

119. *Id.*

120. *Id.*

reasonable efforts to preserve the mission which has been the object of its stewardship.”¹²¹

Although *Manhattan Eye* certainly supports the static charter fidelity norm, its usefulness in jurisdictions outside New York is questionable. *Manhattan Eye* involved a transaction governed by a specific statutory section requiring judicial approval of a charity’s plan to sell a substantial portion of its assets.¹²² The statute expressly required the charity to establish that the terms of the proposed sale would promote “the purposes of the corporation,”¹²³ which may well refer to its historic charter purposes.¹²⁴ The court’s ode to a “duty of obedience” was unnecessary, given this explicit statutory language.

Another case commanding scholarly attention¹²⁵ is *Attorney General v. Hahnemann Hospital*.¹²⁶ In *Hahnemann Hospital*, a nonprofit charity operating a hospital sought judicial blessing¹²⁷ of its proposed sale of hospital assets and its subsequent operation as a grant-making charity.¹²⁸ The court in *Hahnemann Hospital* applied the dynamic charter fidelity norm in one context and the static charter fidelity norm in another. First, the court held that the corporate charity’s board did not violate any fiduciary duty “merely by amending the articles of

121. *Id.* According to the court, the facts demonstrated that the hospital’s board had failed to make “a reasoned and studied determination that there was a lack of need” for the hospital, “or that the financial difficulties made it impossible to ensure the survival” of hospital operations. *Id.* The court noted that it was clear that the desire to sell hospital assets drove the change in the charity’s purposes. *Id.* at 596. Hence, the court determined that the hospital had not made “a showing that the sale will promote the purposes of the corporation,” and declined to approve the sale. *Id.* at 597.

122. See N.Y. NOT-FOR-PROFIT CORP. LAW § 511(a)(6) (McKinney 2005). However, other state statutes do not even expressly require judicial approval of a sale of substantially all of a charity’s assets. See, e.g., TEX. BUS. ORGS. CODE ANN. § 22.252 (West 2012) (allowing the sale of all of a corporation’s assets by a vote of its directors or members with voting rights).

123. N. Y. NOT-FOR-PROFIT CORP. LAW § 511(a)(6).

124. The statutory prong requiring that a sale promote the purposes of the corporation would add little to the law if the “purposes” are merely whatever the charity’s board chooses them to be immediately prior to filing the petition.

125. See, e.g., Atkinson, *supra* note 14, at 81 n.159; Brody, *The Limits*, *supra* note 8, at 1467 & n.310; Susan N. Gary, *The Problems with Donor Intent: Interpretation, Enforcement, and Doing the Right Thing*, 85 CHI.-KENT L. REV. 977, 999 n.141 (2010).

126. 494 N.E.2d 1011 (Mass. 1986).

127. Because the charity and the intended purchaser of the hospital conditioned the sale upon obtaining the approval of the Massachusetts Attorney General and a court, the court declined to decide whether, in the acknowledged absence of a statutory provision on point, judicial approval of the sale would be required. *Id.* at 1017. However, the court did state that the parties’ assumption that judicial approval was required “may be correct.” *Id.*

128. *Id.* at 1013–14. The factual posture of the case is unusual, for the charitable nonprofit corporation received a great deal of its funding from a charitable trust, the terms of the governing instrument of which were incorporated by reference in the charitable corporation’s bylaws. Nonetheless, the rationale of *Hahnemann Hospital* conceivably extends well beyond those facts. *Id.*

organization to provide for the possibility of a sale of all assets.”¹²⁹ Thus, the court applied the dynamic charter fidelity norm in the context of deciding whether charter amendments may be formally adopted.

More interesting, though, is the court’s analysis of the effect of the amendments to charter purposes on assets held before and after the amendment. Two of the amendments were consistent with the terms of the governing instrument of an affiliated charitable trust, whose terms were incorporated by reference into the charitable corporation’s bylaws when the trust originally funded the corporation.¹³⁰ Because donors were on notice under the corporation’s bylaws that its purposes could be expanded to include additional purposes for which the affiliated trust was organized, and further because two amendments to the charter conformed to trust purposes, the court found that these amendments were consistent with the terms of trust,¹³¹ and thus, presumably, pre-amendment donations could be devoted to further such purposes.¹³² However, because the third amendment to charter purposes (which broadly authorized the corporation to promote the health of the general public) exceeded the purposes of the affiliated trust, the court held that the board “will violate their fiduciary duties to those donors if they apply to the third, new purpose any proceeds of the sale attributable to donations from the . . . trust and from unrestricted donations made” before the amendment.¹³³ Just as intriguing is the dicta with which the court concluded its opinion:

[W]e take this opportunity to comment on Hahnemann’s argument that, because under . . . [state statutory law] it may amend its purposes to include any charitable purpose, it may apply its unrestricted funds to any charitable purpose which, by amendment, it includes in its charter. Hahnemann’s reading of . . . [state statutory law] would, in effect, grant to charitable corporations unfettered discretion to apply funds to any charitable purpose. By simply amending its charter purposes, a charitable corporation would itself be able to exercise the power to devote funds to new charitable purposes whenever the trustees decided to do so, without any requirement that the new purposes be similar and not contradictory. The public could not be assured that funds it donated would be used for similar public charitable purposes. . . . Further, the corporation would be able to evade dissolution by reconstituting itself and directing all funds to its newly stated purposes. Such an interpretation also might eviscerate the Attorney General’s power and responsibility to “enforce the due

129. *Id.* at 1018. The court also held that, in amending its corporate purposes to sell its historic (i.e., hospital) assets and then become a grant-making institution, the charity’s board had not violated a fiduciary duty to wind up its affairs in accordance with the state statute. *Id.* at 1019–20.

130. *Id.* at 1020–21.

131. *Id.*

132. *Id.* at 1021.

133. *Id.*

application of [charitable] funds . . . and prevent breaches of trust in the administration thereof.”¹³⁴

This cautionary dicta of *Hahnemann Hospital* strongly suggests that the court broadly embraced the static charter fidelity norm as applied to the management of assets held prior to a charter amendment—at least when there is no provision in the governing instrument specifically notifying donors that their donations can be used to advance amended purposes.

A third case of scholarly note is *Queen of Angels Hospital v. Younger*, which concerned a nonprofit corporation (Queen) that had operated a hospital since its formation in 1927.¹³⁵ Five years later, it added a wing that housed a clinic, which was later operated by an order of Franciscan sisters supervised by Queen’s medical staff.¹³⁶ In 1971, Queen’s board of directors approved a lease of the hospital facilities (except for the outpatient clinic and a convent house) to a for-profit company.¹³⁷ Queen proposed to devote a substantial portion of rental receipts to establish and operate additional medical clinics for the poor.¹³⁸ Opposing the deal, California’s Attorney General argued “that under its articles of incorporation, Queen held its assets in trust primarily for the purpose of operating a hospital, and the use of those assets exclusively for outpatient clinics would constitute an abandonment of Queen’s primary charitable purpose and a diversion of charitable trust assets.”¹³⁹

The court embraced the rule that “all the assets of a corporation organized solely for charitable purposes must be deemed to be impressed with a charitable trust by virtue of the express declaration of the corporation’s purposes,” notwithstanding that donors had not explicitly incorporated such purposes in gift instruments.¹⁴⁰ The court then focused on the precise language of the nonprofit’s charter purposes. It observed that the articles of incorporation named the entity as a “hospital” and that, although the articles referred to multiple purposes, “the framework of those multiple purposes is the operation of a hospital.”¹⁴¹ In summary, the court found that “[t]he articles of incorporation alone—without resort to additional evidence—compel the inference that although Queen is entitled to do many things besides operating a hospital, essential to all those

134. *Id.* (internal footnote omitted).

135. 136 Cal. Rptr. 36, 38 (Ct. App. 1977).

136. *Id.*

137. *Id.* at 38–39.

138. *Id.* at 39.

139. *Id.*

140. *Id.* (citing *Pacific Home v. Cnty. of Los Angeles*, 264 P.2d 539, 543 (Cal. 1953)).

141. *Id.* at 40. The articles of incorporation did not even mention clinics. *Id.* Moreover, although a clause of the charter referred broadly to “acts of Christian charity particularly among the sick and ailing,” the clause “conclude[d] with the conjunctive purpose, ‘to house and care’ for persons, suggesting a hospital facility.” *Id.* Other clauses also implied or referred to the existence of hospital operations. *Id.*

other activities is the continued operation of a hospital.”¹⁴² In short, the court held that although Queen could use some of its assets to further non-hospital-related purposes, it may not “cease to perform the primary purpose for which it was organized.”¹⁴³

Queen of Angels is consistent with older California cases¹⁴⁴ that continue to influence some judges in other jurisdictions.¹⁴⁵ Whether these cases remain controlling under California law has been questioned, insofar as they pre-date the 1980 enactment of California’s nonprofit corporation act.¹⁴⁶ However, the California Attorney General continues to embrace the trust law analysis in these cases,¹⁴⁷ as do some attorneys general in other states.¹⁴⁸

c. Case Law Supporting the Dynamic Charter Fidelity Norm

Consistent with the PLNO, and contrary to the approach of *Manhattan Eye, Hahnemann Hospital*, and *Queen of Angels*, some cases support or implicitly embrace the dynamic charter fidelity norm as applied to a charity’s post-amendment use of assets held prior to an amendment to its articles of incorporation. For example, in *Kansas East Conference of the United Methodist Church, Inc. v. Bethany Medical Center, Inc.*, a Methodist conference of churches (“the Conference”) sought a declaratory judgment and an order to

142. *Id.* The court then buttressed its reasoning by demonstrating that Queen had long operated a hospital and had held itself out to the public (i.e., governmental authorities and donors) as doing so. *Id.* at 40–41.

143. *Id.* at 41.

144. See, e.g., *Holt v. Coll. of Osteopathic Physicians & Surgeons*, 394 P.2d 932, 938–39 (Cal. 1964) (ruling that the complaint of the minority trustees of a charitable corporation stated a cause of action by alleging that the majority trustees sought to abandon the corporation’s historic, charter purpose to conduct an osteopathic medical and surgical college and to convert it into a school teaching allopathic medicine and surgery); *In re Los Angeles Cnty. Pioneer Soc.*, 257 P.2d 1, 6 (Cal. 1953) (quoting *In re Clippinger’s Estate*, 171 P.2d 567, 572 (Cal. Ct. App. 1946)) (“[A] devise to a society organized for a charitable purpose without a declaration of the use to which the gift is to be put is given in trust to carry out the objects for which the organization was created.”); *Brown v. Mem’l Nat’l Home Found.*, 329 P.2d 118, 129 (Cal. Ct. App. 1958) (holding that funds raised by a nonprofit corporation to benefit needy members of its controlling entity were “impressed with a trust for the exclusive benefit” of those members notwithstanding subsequent charter amendments).

145. See, e.g., *Banner Health Sys. v. Long*, 663 N.W.2d 242, 250 (S.D. 2003) (ruling that, if South Dakota’s Attorney General can demonstrate that amendments to the corporate charter of a hospital corporation’s predecessor affected nonmembers’ rights, “a constructive charitable trust may be imposed on those assets donated to the local facilities”). The court noted that “[o]ther courts have held that an amendment of a nonprofit corporation’s bylaws for the purpose of changing the corporate purpose was an abuse of the charitable trust created in gifts given to the corporation prior to the amendment.” *Id.* (citing *Los Angeles Cnty. Pioneer Soc.*, 257 P.2d at 7–8).

146. Greaney & Boozang, *supra* note 8, at 66.

147. For a discussion of this point, see Brody, *The Limits*, *supra* note 8, at 1468 & n.311.

148. See, e.g., John W. Vinson, *The Charity Oversight Authority of the Texas Attorney General*, 35 ST. MARY’S L.J. 243, 272–73 (2004).

dissolve Bethany Medical Center, Inc. (“Bethany”) and distribute its assets to the Conference.¹⁴⁹ Bethany held approximately \$40–45 million in cash after it sold its hospital assets to a for-profit company.¹⁵⁰ At the time of the litigation in question, Bethany’s articles of incorporation permitted its board to amend them, and stated that upon dissolution, Bethany’s net assets would be distributed to the Conference.¹⁵¹ The lower court refused to order that Bethany be dissolved, but it did issue a permanent injunction prohibiting Bethany from displacing the Conference as the recipient of the assets if Bethany was dissolved.¹⁵²

The Kansas Supreme Court rejected the Conference’s argument that charitable trust law, rather than the statutory language of the Kansas Corporation Code, should control the disposition of the case.¹⁵³ The court dismissed the notion that the Conference functioned “as a trust settlor,” and emphatically concluded that “dissolution of Bethany is governed by the corporate statutes.”¹⁵⁴ Having rejected the application of trust law to the question of whether Bethany must be dissolved, the court then addressed the trial court’s injunction against amending Bethany’s articles so as to displace the Conference as the distributee of Bethany’s assets in the event of Bethany’s dissolution.¹⁵⁵ Bethany argued that the court violated its due process rights by entering the injunction without any notice or hearing on the issue.¹⁵⁶ Bethany’s argument required proof that it possessed a legally-protected interest which it could not be deprived of without notice and an opportunity to be heard.¹⁵⁷ The Kansas Supreme Court accepted the argument that state nonprofit law created a property interest in Bethany,¹⁵⁸ and then linked its analysis rejecting the application of trust law to the question of the propriety of the lower court’s injunction.¹⁵⁹ The court concluded that “the district court interfered in the internal affairs of Bethany by enjoining it from

149. 969 P.2d 859, 860 (Kan. 1998).

150. *Id.* at 861.

151. *Id.* at 862.

152. *Id.*

153. *Id.* at 863.

154. *Id.* at 864.

155. *Id.* at 866–67.

156. *Id.* at 867.

157. *See id.* at 867 (noting that the due process rights of the Fifth and Fourteenth Amendments attach only to deprivation of life, liberty, or property).

158. *Id.* at 868.

159. *See id.* at 870 (“The resolution of Bethany’s cross-appeal [on the injunction] is affected by our decision in the direct appeal by the Conference. We have approved the district court’s refusal to dissolve Bethany, ruling that a corporation is a creation of statute and dissolution is controlled by the Kansas Corporation Code. Notwithstanding that ruling, the district court proceeded to control the future operation of Bethany by enjoining it from amending its articles of incorporation.”).

amending its articles of incorporation as to the distribution of its assets upon dissolution.”¹⁶⁰ Issuing the injunction, therefore, denied Bethany due process.¹⁶¹

Bethany Medical Center supports the dynamic charter fidelity norm in both its rationale and holding. The case rejects the notion that charitable trust law trumps state nonprofit statutes that confer power to a governing board to amend an entity’s articles of incorporation and act accordingly.¹⁶² Although the court considered the issue in the context of preserving the right of directors to amend the entity’s dissolution clause (and thereby redirect the disposition of corporate assets upon dissolution) the rationale of the case would also apply to the right of directors to amend an entity’s purposes clause, and thereby redirect the use of corporate assets in daily operations.¹⁶³

Another case that broadly supports the dynamic charter fidelity norm is *Dodge v. Trustees of Randolph-Macon Woman’s College*.¹⁶⁴ In this case, the plaintiffs brought suit to enjoin the Randolph-Macon Woman’s College (“the College”), a single-sex liberal arts college, from implementing its plan to become co-educational.¹⁶⁵ The College sought to amend its articles of incorporation to include men and women, and planned to sell assets, including its art collection, to finance campus alterations that would facilitate the transition to a co-educational institution.¹⁶⁶ The plaintiffs argued that the College is a charitable trust under state law, and that the assets of the College are held in trust in furtherance of the College’s charitable purposes as set forth in its articles of incorporation, as they existed when the College received the assets as gifts.¹⁶⁷ In support of their argument, the plaintiffs cited a state statute characterizing the assets of a charitable corporation as being held in trust.¹⁶⁸

160. *Id.*

161. *Id.*

162. *See id.* at 863 (holding that the dissolution of the corporation is controlled by the Kansas Corporation Code, not charitable trust law).

163. The Kansas Supreme Court did not view this right of directors as unlimited, however. The court approvingly cited *Croon v. Tanner*, 229 P.2d 1008, 1013 (Kan. 1951), for the proposition that “only when the officers [of a corporation] are guilty of willful abuse of their discretionary power or of bad faith, neglect of duty, perversion of the corporate purpose, or when fraud or breach of trust are involved,” will courts interfere with the exercise of their judgment. *Bethany Med. Ctr.*, 969 P.2d at 870. Also noteworthy is that one of the lower court’s rulings, which was not contested on appeal, required Bethany to use the proceeds from the sale of hospital assets “to improv[e] the health of Wyandotte County citizens, particularly indigent ones.” *Id.* at 862. Thus, the lower court fell short of fully embracing the dynamic charter fidelity norm. Because this ruling was uncontested, however, the Kansas Supreme Court had no reason to address it.

164. 661 S.E.2d 805 (Va. 2008).

165. *Id.* at 806–07.

166. *Id.* at 807.

167. *Id.*

168. *See* VA. CODE ANN. § 2.2-507.1.A (2011) (“The assets of a charitable corporation incorporated in or doing any business in Virginia shall be deemed to be held in trust for the public for such purposes as are established by the governing documents of such charitable corporation, the gift or bequest made to such charitable corporation, or other applicable law. The Attorney

The Virginia Supreme Court rejected the plaintiffs' argument that the statute in question "requires the application of trust law, rather than corporate law, to the College."¹⁶⁹ The Court explained that the plaintiffs' theory "would transform all charitable Virginia nonstock corporations into charitable trusts" and would erroneously lead one to assume legislative intent to effect "a drastic change in Virginia's established law."¹⁷⁰ According to the court, the statute "simply confers upon the Attorney General the authority to act on behalf of the public to protect the public's interest in assets held by charitable corporations."¹⁷¹ The statute does not, however, impose duties on charitable corporations,¹⁷² hence, directors of charitable corporations are subject to the same standards governing directors of all nonstock corporations under Virginia statutory and common law.¹⁷³

Dodge rejects the notion that a charitable corporation holds its assets in trust in any comprehensive or far-reaching sense, as well as the idea that directors of charitable corporations owe duties in addition to those owed generally by directors of nonprofit corporations. Although the Virginia Supreme Court in *Dodge* did not consider the plaintiffs' argument that the lower court erred by concluding that the doctrine of cy pres did not apply,¹⁷⁴ the opinion's rationale is consistent with the lower court's ruling.¹⁷⁵ By emphasizing that state nonprofit corporate law governs charitable corporations and their directors, *Dodge* strongly suggests that directors have the power to amend the charter purposes clauses of the corporations that they govern and deploy corporate assets to pursue those purposes.¹⁷⁶

Another case supporting the dynamic charter fidelity norm is *City of Hughes Springs v. Hughes Springs Volunteer Ambulance Service*, in which a nonprofit corporation, originally formed to operate an ambulance service, was impeded from performing its primary historical purpose by local law enforcement and the city council.¹⁷⁷ The nonprofit corporation responded by amending its charter purposes "to provide various services to the community which relate to the

General shall have the same authority to act on behalf of the public with respect to such assets as he has with respect to assets held by unincorporated charitable trusts and other charitable entities, including the authority to seek such judicial relief as may be necessary to protect the public interest in such assets.").

169. *Dodge*, 661 S.E.2d at 808.

170. *Id.*

171. *Id.* at 809.

172. *Id.* The court observed that section 2.2-507.1.B of the Virginia Code states that the provision relied upon by the plaintiffs is not "intended to modify the standard of conduct applicable under existing law to the directors of charitable corporations." *Id.*

173. *Id.* The court observed that Virginia's trust code does not apply to the College. *Id.*

174. *Id.*

175. *See id.* at 807 (noting that the circuit court also held that the Uniform Trust Code was inapplicable to the situation).

176. *See id.* at 808 (rejecting the contention that trust law applies to nonprofit corporations).

177. 223 S.W.3d 707, 711-12 (Tex. Ct. App. 2007).

health and safety of the citizens in the Hughes Springs area.”¹⁷⁸ A member of the nonprofit corporation and the City of Hughes Springs petitioned the court to dissolve and liquidate the entity.¹⁷⁹ They relied on a provision of the Texas Nonprofit Corporation Act¹⁸⁰ that required a court to liquidate a nonprofit corporation if “the corporation is unable to carry out its purposes.”¹⁸¹

The court held that the amendments were valid.¹⁸² In view of the propriety of the amended charter purposes, the court ruled that the plaintiffs did not prove that the nonprofit was no longer able to carry out its purpose.¹⁸³ In fact, the court held that the nonprofit “is able to carry out its purposes as amended.”¹⁸⁴ In reaching its decision, the court rebuffed the member’s attempt to buttress her argument by claiming that the doctrine of *cy pres* required the liquidation of the corporation under the statutory provision at issue.¹⁸⁵ Although it was not well explained in the opinion, the members apparently theorized that, because the original purpose of the charitable nonprofit had failed, the court’s act of liquidating the corporation under the authority of the statute would be consistent with the doctrine of *cy pres*, insofar as dissolution could effectuate devotion of corporate assets to a similar use.¹⁸⁶ However, the court concluded that “[t]he doctrine of *cy pres* does not prohibit the [nonprofit] from amending its purpose or require the [nonprofit] to be dissolved.”¹⁸⁷ Taking some license with the scope of the doctrine, the court asserted that “even if the [nonprofit] is a charity, its assets will be converted from one charitable purpose to another charitable purpose—consistent with the doctrine of *cy pres*.”¹⁸⁸

Although the *Hughes Springs* court could have better expressed the *cy pres* argument, the important point is that the court refused to apply trust law concepts to override the ability of a board of directors of a charitable nonprofit corporation to amend its articles in accordance with state statutory law and then use its assets to further post-amendment purposes. The opinion rejects the static charter fidelity norm as applied to the use of corporate assets following an amendment to a charitable corporation’s purposes clause.

178. *Id.* at 714.

179. *Id.* at 709.

180. TEX. REV. CIV. STAT. ANN. art. 1396-7.06 (West 2003). The statute has since been amended and no longer exists. *Hughes Springs*, 223 S.W.3d at 710 n.2.

181. *Hughes Springs*, 223 S.W.2d at 709–10 (quoting TEX. REV. CRIM. STAT. ANN. Art. 1396-7.06 (West 2003) (repealed 2010)).

182. *Id.* at 715.

183. *Id.* at 716.

184. *Id.*

185. *Id.* at 715–16.

186. Under the nonprofit corporation’s original articles of incorporation, the City of Hughes Springs was the designated distributee of assets upon dissolution of the corporation. *Id.* at 711.

187. *Id.* at 716.

188. *Id.*

4. *What Charter Fidelity Norm Governs the Distribution of Assets in Dissolution and Liquidation of a Charitable Nonprofit Corporation?*

A related issue is whether a charity desiring to terminate its existence may, pursuant to a plan of dissolution, transfer its assets to a charity with purposes dissimilar to those expressed in its charter. Some state statutes require dissolving charities to distribute assets to organizations having charitable purposes similar to those of the dissolving entity.¹⁸⁹ Other statutes provide simply that the corporation must distribute its assets to other tax-exempt charities or governmental bodies.¹⁹⁰ If the state statute governing distributions in dissolution expressly requires the dissolving entity to transfer assets to other charities with purposes similar to the longstanding express purposes of the dissolving entity, the statute functionally embraces the static charter fidelity norm, at least in part. If the state statute does not explicitly require a dissolving entity to distribute assets only to a charitable transferee with specific purposes similar to those of the transferor, a court may be asked to decide whether to employ common law trust concepts to compel such a result.¹⁹¹

Blocker v. State illustrates this issue.¹⁹² In *Blocker*, the court held that the directors of a charitable corporation breached their fiduciary duties by attempting to distribute corporate assets in dissolution to a private estate in which several directors had a personal interest.¹⁹³ Although the holding itself is unremarkable, its rationale is potentially far-reaching. The court accepted the state's argument that the charter of a charitable corporation constitutes a declaration of charitable trust.¹⁹⁴ The court held that property transferred to a charitable corporation is "subject to implicit charitable or educational limitations defined by the donee's organizational purpose and within the meaning of the statute, where no express limitation to the contrary is stated in the transfer."¹⁹⁵ According to the court, property that could be traced to such assets was likewise held by the charity "subject to the limitations imposed on the corporation by the terms of its own articles of incorporation."¹⁹⁶ Under this theory, the court

189. See, e.g., GA. CODE ANN. § 14-3-1403(b)(3) (2003) (requiring the assets to be transferred to an organization "engaged in activities substantially similar to those of the dissolving corporation"); N.Y. NOT-FOR-PROFIT CORP. LAW § 1002-a(c)(1) (McKinney 2013) (same).

190. See, e.g., TEX. BUS. ORGS. CODE ANN. § 22.304(a)(2) (West 2012) (providing that the remaining assets of a nonprofit corporation be distributed to other tax-exempt organizations, unless the corporation's certificate of formation has an alternate provision).

191. See generally FREMONT-SMITH, *supra* note 16, at 184–85 (explaining that, while some states have codified the cy pres principles, other states still allow common law to govern whether or not cy pres applies).

192. 718 S.W.2d 409 (Tex. Ct. App. 1986).

193. *Id.* at 415.

194. *Id.* at 416.

195. *Id.* at 415.

196. *Id.*; see also *id.* ("We hold that the real property and personalty were assets received and held by the corporation, whether from donation or purchase, subject to limitations permitting their

concluded that distributions in liquidation were governed by a statutory dissolution provision applicable to “[a]ssets received and held by the corporation subject to limitations permitting their use only for charitable, religious, eleemosynary, benevolent, educational or similar purposes.”¹⁹⁷ The provision generally required a dissolving nonprofit corporation to transfer such assets upon dissolution to organizations engaged in activities substantially similar to those in which the dissolving entity had engaged.¹⁹⁸

Because the court in *Blocker* construed a statutory provision that has since been repealed, one could argue that the “statutory duty” that the provision created has vanished, and never even existed in other states with liberal provisions governing distributions in liquidation of a charitable nonprofit corporation. However, *Blocker* conceptualized donations received by a corporation as restricted gifts in trust, restricted for the purposes of the donee at the time of the donation.¹⁹⁹ Just as assets restricted by the terms of a gift instrument must be distributed in a manner consistent with the restriction when the donee dissolves, so might a court influenced by *Blocker* conclude that assets restricted by the terms of the donee’s charter (at the time of the donation) must be similarly distributed upon the donee’s dissolution, even if state statutory law permits distributions to any charitable corporation. The question essentially requires a court to choose between the static charter fidelity norm and the dynamic charter fidelity norm. Case law exists that supports each conflicting view.²⁰⁰

C. Mission Fidelity Norms

There is less precedent that directly and clearly articulates the mission fidelity norms. Mission fidelity norms have received at least modest judicial recognition, although it is difficult to discern their impact apart from charter fidelity norms. The two types of norms are theoretically distinct because a charity’s mission (for example, operating an elementary school) may be more

use only for educational purposes, by reference to the stated purposes set forth in the articles of incorporation.”).

197. *Id.* at 412, 415 (quoting the then-existing Article 1396-6.02.A(3) of the Texas Non-Profit Corporation Act, which has since been repealed).

198. *See id.* (quoting Article 1396-6.02(a)(3) of the Texas Non-Profit Corporation Act, which has since been repealed) (“Assets received and held by the corporation subject to limitations [on their use] . . . shall be transferred or conveyed to one or more domestic . . . corporations . . . engaged in activities substantially similar to those of the dissolving corporation.”).

199. *See id.* at 415 (“We further hold that the acceptance of [assets held by the corporation from donations] established a charitable trust for the declared purposes as effectively as though the assets had been accepted subject to an express limitation providing that the gift was held in trust solely for such charitable purposes.”).

200. At least one case decided after *Blocker v. State* undermines the application of trust law principles to Texas nonprofit corporations. *See City of Hughes Springs v. Hughes Springs Volunteer Ambulance Serv., Inc.*, 223 S.W.3d 707, 715–16 (Tex. Ct. App. 2007) (refusing to apply the trust law principle of cy pres to a nonprofit corporation in Texas).

specific than the purposes expressly articulated in the charity's corporate charter (for example, advancing charitable and educational purposes).

1. *Support for the Historic Mission Fidelity Norm*

A few cases arguably embrace the historic mission fidelity norm, most notably in cases where a board seeks to devote funds to purposes that deviate from an entity's longstanding mission.²⁰¹ For example, in *Manhattan Eye*, it was "axiomatic that the Board of Directors is charged with the duty to ensure that the mission of the charitable corporation is carried out."²⁰² Further, the court opined that deviating "from the charity's central and well-understood mission should be a carefully chosen option of last resort."²⁰³ Taken at face value, these statements reflect adoption of the historic mission fidelity norm. However, it is unclear whether the court assigned significance to the historic mission fidelity norm apart from the static charter fidelity norm. In *Manhattan Eye*, the purposes clause of the charity's articles of incorporation articulated its specific mission, a fact that did not escape the attention of the court.²⁰⁴

Queen of Angels offers additional judicial support for historic mission fidelity. After stating that the hospital's articles of incorporation alone were sufficient to impress donations with a charitable trust, the court buttressed its conclusion with the observation that Queen had actually operated a hospital throughout its

201. In addition to the case law discussed in the text, some state statutes advance, or at least tend to favor, the historic mission fidelity norm in the way that they regulate charitable hospital conversions. *See, e.g.*, CAL. CORP. CODE § 5917(e) (West 2013) (listing as one of the factors that the Attorney General should consider in giving (or withholding) consent to a proposed hospital conversion whether "[t]he proposed use of the proceeds from the agreement or transaction is consistent with the charitable trust on which the assets are held by the health facility"); GA. CODE ANN. § 31-7-406(9) (2012) (requiring that the state-mandated public hearing conducted by the Attorney General in connection with the acquisition of a nonprofit hospital address several factors, including "[w]hether any disposition proceeds will be used for appropriate charitable health care purposes consistent with the nonprofit corporation's original purpose or for the support and promotion of health care in the affected community"); NEB. REV. STAT. ANN. § 71-20, 108(8) (LexisNexis 2008) (stating that the Attorney General will approve the acquisition of a nonprofit hospital if doing so is in the public interest; the Attorney General should consider, among other factors, whether proceeds of the transaction are "used for appropriate charitable health care purposes consistent with the seller's original purpose or for the support and promotion of health care in the affected community"); R.I. GEN. LAWS § 23-17.14-7(c)(16) (2012) (requiring the Attorney General to review a proposed nonprofit hospital conversion and consider, among other factors, "[w]hether the proposed conversion results in an abandonment of the original purposes of the existing hospital or whether a resulting entity will depart from the traditional purposes and mission of the existing hospital such that a cy pres proceeding would be necessary"). *See generally* Frost, *supra* note 8, at 953–57 (summarizing state laws governing charitable hospital conversions and stating that the statutes generally require a showing "that the proceeds will be applied to a charitable purpose that is generally consistent with the founder's or donor's intent").

202. *In re Manhattan Eye, Ear & Throat Hosp. v. Spitzer*, 715 N.Y.S.2d 575, 593 (Sup. Ct. 1999).

203. *Id.* at 595.

204. *See id.* (referring to the charity's "mission, as stated in its Certificate of Incorporation").

history, represented to governmental taxing authorities that it was a hospital, and solicited public donations for hospital purposes.²⁰⁵ The court concluded that Queen “was intended to and did operate a hospital and cannot, consistent with the trust imposed upon it, abandon the operation of the hospital business in favor of clinics.”²⁰⁶ Although this portion of the opinion was dictum, it reflects judicial acceptance of the historic mission fidelity norm as applied to the use of funds received and accumulated while the nonprofit was carrying out its traditional mission.

2. Support for the Dynamic Mission Fidelity Norm

Not all cases support rigid adherence to a charitable corporation’s historic mission, however. For example, *Bethany Medical Center* tends to reject the historic mission fidelity norm. In *Bethany Medical Center*, the Conference argued that Bethany should be dissolved under state law because it had “contracted away its purpose” by selling hospital assets.²⁰⁷ The Kansas Supreme Court disagreed, reasoning that the sale did not devoid Bethany of purpose because operating a hospital was “only one of several health-care related purposes pursued by Bethany.”²⁰⁸

Similarly, the court in *Hughes Springs* held that the doctrine of cy pres did not prohibit a nonprofit corporation originally formed to operate an ambulance service from amending its purposes so as “to provide various services to the community which relate to the health and safety of the citizens in the Hughes Springs area.”²⁰⁹ The court also refused to order dissolution of the corporation, for it was perfectly capable of fulfilling its amended purposes.²¹⁰ By endorsing the legitimacy of the corporation’s use of assets to further its amended charter purposes, the court rejected both the static charter fidelity norm and the historic mission fidelity norm.

Although these cases reject the historic mission fidelity norm, they do not necessarily embrace the dynamic mission fidelity norm. Affirming the dynamic mission fidelity norm not only imposes an affirmative obligation to advance the charity’s specific mission upon charity fiduciaries, but also allows the governing

205. *Queen of Angels Hosp. v. Younger*, 136 Cal. Rptr. 36, 40–41 (Ct. App. 1977).

206. *Id.* at 41. *Cf. Holt v. Coll. of Osteopathic Physicians & Surgeons*, 394 P.2d 932, 938 (Cal. 1964) (“Plaintiffs allege that defendant trustees threaten to divert the assets of COPS to purposes other than those for which it was organized and for which COPS has in the past solicited and received funds in trust.”).

207. *Kan. E. Conference of the United Methodist Church, Inc. v. Bethany Med. Ctr., Inc.*, 969 P.2d 859, 864 (Kan. 1998).

208. *Id.* at 866.

209. *City of Hughes Springs v. Hughes Springs Volunteer Ambulance Serv.*, 223 S.W.3d 707, 714, 716 (Tex. Ct. App. 2007).

210. *Id.* at 714.

board to amend the mission.²¹¹ Some language in case law tends to support this approach,²¹² but it is unclear whether existing authorities actually impose an obligation on charity fiduciaries to advance a charitable mission that is more specific than its charter purpose. Insofar as the PLNO recognizes both the utility of adopting mission statements and the need to evaluate grounds for altering a charity's mission over time, it at least partially embraces the dynamic mission fidelity norm.²¹³

D. The Charity Advancement Norm

State law consistently supports the elementary charity advancement norm and its negative corollary. That it does so follows from the fundamental nature of charitable nonprofit corporations and the statutes authorizing them. Directors of a charitable nonprofit corporation must govern in a way that promotes compliance with the corporation's charter.²¹⁴ Accordingly, a nonprofit corporation organized for charitable purposes must advance "charitable," as opposed to non-charitable, purposes. Certainly, the typical nonprofit corporation statute authorizes a nonprofit corporation to have purposes broader than those that the law recognizes as "charitable."²¹⁵ However, because corporations organized for charitable purposes are typically incorporated under nonprofit corporation statutes that require compliance with charter purposes, it is accurate to state that a charity's compliance with its charter requires that it serve a charitable purpose. Thus, the essential structure of the statutory law of nonprofit charitable corporations is designed to promote the charity advancement norm and its negative corollary.

E. Summary

State case law and statutes governing directors of nonprofit corporations clearly embrace the legality norm and the charity advancement norm, together with its negative corollary. The status of other obedience norms governing charity fiduciaries varies among the states.

211. *See, e.g.*, Sugin, *supra* note 8, at 904–05 (proposing a legal requirement that directors advance a charity's mission, but arguing for a flexible requirement that allows directors to amend a charity's purpose).

212. *See, e.g.*, *Oberly v. Kirby*, 592 A.2d 445, 468–69 n.17 (Del. 1991) (noting the director's duty to promote a charity's mission and the Attorney General's ability to challenge a board decision that is in direct conflict with a charity's mission).

213. *See, e.g.*, PRINCIPLES OF THE LAW OF NONPROFIT ORGS. § 320(b) cmt. e. (recognizing the importance of developing a clear mission statement, but explaining that the board should be able to alter the mission statement when needed).

214. *See supra* Part III.B.1.

215. *See, e.g.*, 15 PA. CONS. STAT. ANN. §5301(a) (West 1995) (allowing for the creation of a nonprofit corporation, and providing a non-exhaustive list of examples); TEX. BUS. ORGS. CODE ANN. § 22.051 (West 2012) (permitting the creation of a nonprofit corporation "for any lawful purpose").

State laws embrace norms of charter fidelity, but they differ in whether they impose the static charter fidelity norm or the dynamic charter fidelity norm. Most states adopt the dynamic charter fidelity norm as applied solely to the formal ability of a governing board to amend the charity's governing instrument. But in other contexts, in which the question involves the freedom of directors to direct corporate assets to uses that differ from historic corporate purposes, the states take drastically different approaches. Some states rely on trust law principles and impose the static charter fidelity norm on directors, whereas others apply corporate law concepts broadly and hold directors to the dynamic charter fidelity norm. In one state, different courts have embraced different norms.

Whether states impose some form of the mission fidelity norm that is independent of a charter fidelity norm is debatable. Some authorities appear to embrace the historic mission fidelity norm, but do so in contexts in which the norm largely coincides with the static charter fidelity norm. Other judicial authorities reject the historic mission fidelity norm, but fall short of clearly embracing the dynamic mission fidelity norm.

Reform efforts have not resolved the states' differing approaches. The RMNCA and the MNCA Third do not wrestle with the difficult issues raised by the choice of obedience norms. The PLNO embraces the dynamic charter fidelity norm and offers some support for the dynamic mission fidelity norm. States have yet to look to the PLNO for guidance on these issues, however.

This survey of the law of obedience norms governing charity fiduciaries suggests the importance of identifying the precise purposes that obedience norms serve. Before one can determine "what" obedience norms should govern, one must ponder "why" we need them.

IV. THE PURPOSE OF OBEDIENCE NORMS

The major justifications for obedience norms can be categorized as follows: (1) ensuring the presence of public benefit,²¹⁶ (2) promoting equity,²¹⁷ and (3) encouraging efficiency.²¹⁸

A. Public Benefit

Ensuring that charitable organizations benefit the public is the most basic purpose of obedience norms.²¹⁹ In fact, the law defines a "charitable purpose"

216. See Buckles, *supra* note 20, at 214 (noting that a "public benefit" is the "fundamental purpose" of obedience norms).

217. See *id.* at 215–16 (explaining that equity is another purpose of obedience norms).

218. See *id.* at 217–19 (suggesting that reliance-based and experience-based efficiency could also be purposes of obedience norms).

219. *Id.* at 214; *cf.* Fremont-Smith & Lever, *supra* note 8, at 717 ("[T]here is great merit in the common law regulatory scheme under which the state does not dictate the actions of fiduciaries,

as one that is beneficial to the public.²²⁰ To require fiduciaries to advance “charitable” purposes is therefore an attempt to promote public benefit. Of course, requiring fiduciaries to advance charitable purposes (and not others) is the essence of the charity advancement norm and its negative corollary. Additionally, the legality norm generally complements the charity advancement norm by discouraging behavior deemed detrimental to the public. Thus, the public benefit justification for obedience norms supports adoption of the charity advancement norm and its negative corollary, and supports imposition of the legality norm as well.

A more difficult question is whether the public benefit justification supports the adoption of additional obedience norms. Charter fidelity norms reinforce the charity advancement norm by reminding fiduciaries of the activities that they can and cannot cause their charities to undertake. Although the charity advancement norm may be sufficient in theory to ensure that a charity produces public benefit,²²¹ some form of charter fidelity norm is useful in prompting charity fiduciaries to adhere to the charity advancement norm. A similar argument can be made in favor of the mission fidelity norm, because requiring governance in accordance with a mission focuses attention on advancing charity thoughtfully. The dynamic fidelity norms would serve these functions just as well as the static norms, however.

Indeed, it is doubtful that the public benefit justification requires adoption of any “static” obedience norm (static charter fidelity or historic mission fidelity). Substantive government approval of an entity’s choice of charitable purpose and mission is generally not required upon formation of a charitable entity.²²² A plausible explanation for this reality is that the law recognizes that the choice of charitable purpose by private actors suffices to promote public benefit if it is assumed that pursuing *any* charitable purpose produces public benefit. Why, then, should substantive, *ex ante* governmental approval be necessary to ensure the presence of public benefit when an entity’s governing board decides to alter charitable purpose or mission? One can articulate (questionable) justifications grounded in equity and efficiency for such approval, but ensuring the presence of some public benefit does not seem a persuasive justification for either static norm.

but rather monitors them to assure continued dedication to public purposes.”); Sugin, *supra* note 8, at 913–18 (discussing the public interest in a charity’s fulfillment of its mission and discrediting a donor-centric approach to evaluating nonprofit fiduciary duties).

220. See, e.g., RESTATEMENT (THIRD) OF TRUSTS § 28(f) (2003) (stating that charitable trust purposes include “other purposes that are beneficial to the community”); *id.* cmt. a (“The common element of charitable purposes is that they are designed to accomplish objects that are beneficial to the community—i.e., to the public or indefinite members thereof—without also serving what amount to private trust purposes . . .”).

221. Such sufficiency obviously depends upon whether pursuing the purposes that the law recognizes as “charitable” does, in fact, produce public benefit.

222. See, e.g., MODEL NONPROFIT CORP. ACT. § 1.25(a) (3d ed. 2009) (stating that the Secretary of State is required to file articles of incorporation that conform to law).

B. Equity

Another possible justification for obedience norms is that they promote equity by protecting the reliance interests of donors, and perhaps other stakeholders.²²³ The theory is that donors have donated funds to charitable entities under the assumption that the money will be used to perform the donee's charitable purposes as they exist when the funds are received.²²⁴ To allow the charity to alter its purposes, or perhaps even mission, after receiving such donations is unfair to those donors because of their reliance on the then-existing purposes/mission of the donee. This rationale appears to be a favorite of the courts and commentators embracing static obedience norms.²²⁵ However, the equity rationale has limited appeal in the case of charitable trusts, and considerably less persuasive force as applied to charitable nonprofit corporations. Further, the reliance-based equity justification does not support all obedience norms equally, even in the case of charitable trusts.

Because of long-standing legal deference to the terms of trusts in general²²⁶ and the application of the doctrine of cy pres to charitable trusts,²²⁷ those who currently contribute to charitable trusts properly assume that the trust's express charitable purposes will typically remain unchanged. But this general observation justifies upholding donors' reliance interests on equity grounds only for as long as the law continues to apply cy pres or some similar doctrine. Were the law to change, those who subsequently donate to charitable trusts would lack a compelling reliance interest in static charter fidelity.²²⁸ Further, even under current law, those who donate to charitable trusts properly assume that the static charter fidelity norm applies only when the terms of trust do not authorize amendments by the trustees. If the terms of trust provide a mechanism for the trustees to amend the trust terms without judicial proceedings, those terms

223. Buckles, *supra* note 20, at 215.

224. *Id.*

225. *See, e.g.*, Att'y Gen. v. Hahnemann Hospital, 494 N.E.2d 1011, 1021 (Mass. 1986) (noting that, if the charity could freely amend its charter purpose, "[t]he public could not be assured that funds it donated would be used for similar public charitable purposes"); Queen of Angels Hosp. v. Younger, 136 Cal. Rptr. 36, 40-41 (Ct. App. 1997) (explaining that Queen was bound to its purpose of operating a hospital because, among other reasons, it had solicited donations from the public for the hospital); Frost, *supra* note 8, at 944-45, 951 (arguing that donors would be unlikely to give without assurance that the funds would be used to further corporate purposes).

226. *See supra* Part II.A.1.

227. The general inability to amend the purposes of a charitable trust absent cy pres proceedings is longstanding. *See, e.g.*, RESTATEMENT (THIRD) OF TRUSTS § 67 cmt. a (2003). For a discussion of cy pres, see *supra* Part II.B.2.

228. Were the law to change, donors to charitable trusts would not have grounds for relying on defunct doctrine. It is circular to argue that equity concerns justify continued imposition of the static charter fidelity norm on trustees of charitable trusts merely because (1) donors assume the existence of the static charter fidelity norm; and (2) they do so because the law imposes it.

control.²²⁹ A donor who gives to a charitable trust that permits amendments to its purposes clause therefore has no strong reliance interest in the fixed terms of trust.²³⁰

Moreover, even in the case of a charitable trust that does not provide for amendments by trustees, trust law does not support adoption of the historic mission fidelity norm. The classic expression of the duty to obey terms of trust that the law imposes on trustees applies only with respect to the actual *terms of trust*. An action in cy pres is necessary to alter charitable purposes only when administering the *terms of trust* becomes impossible, illegal, impracticable, or wasteful.²³¹ The classic articulation of cy pres does not require trustees of charitable trusts to go to court to bless a new charitable mission that falls within the express charitable purposes of the trust.²³² Hence, donors to a charitable trust have no strong reliance interest in any particular charitable mission of a trust when other charitable missions would also further express the trust's purposes.

Reliance-based equity offers an even less compelling justification for static obedience norms in the case of charitable corporations. Nonprofit corporation statutes typically enable charter amendments without court approval,²³³ immediately distinguishing them from charitable trusts, which are governed by default rules requiring court approval of amendments to a trust instrument.²³⁴ Donors to charitable nonprofit corporations are on notice of these corporate laws. It is plausible that the average donor would assume that static obedience norms do not govern directors of charitable nonprofit corporations, perhaps even as applied to their power to deploy existing assets to advance new charitable purposes.²³⁵ If donors do assume such flexibility, rejection of static obedience norms does not defeat their reliance interests.

Moreover, if the law across the states consistently assumed contrary donor expectations, counsel to nonprofit charitable corporations could draft governing

229. See RESTATEMENT (THIRD) OF TRUSTS § 64(1) (2003) (“[T]he trustee or beneficiaries of a trust have only such power to terminate the trust or to change its terms as is granted by the terms of the trust.”).

230. The sole “donor” of many charitable trusts is simply its settlor. However, a founder who contemplates large scale future public support may still choose the charitable trust form of operating a charity. Such a charity would have multiple donors.

231. See *supra* notes 89–91 and accompanying text.

232. Cf. SCOTT, *supra* note 89 (describing how difficult it can be for a court, in the context of charitable trusts, to apply cy pres to determine the alternate disposition a settlor would want); see also *supra* notes 89–91 and accompanying text.

233. See *supra* note 107 and accompanying text.

234. See *supra* notes 77–79, 89 and accompanying text.

235. See Buckles, *supra* note 20, at 216 (“Because of these typically liberal statutory amendment procedures, and absent specific statutory directives to the contrary, donors may assume that a charitable corporation can use gifts unaccompanied by any explicit donor-imposed restriction or explicit charity-imposed limitations for any bona fide ‘charitable’ purpose.”)(footnote omitted); cf. Brody, *The Limits*, *supra* note 8, at 1418 n.76 (observing that “a corporate charity might more easily change its purposes than a charitable trust”).

documents to undermine the basis for maintaining the assumption.²³⁶ Lawyers could draft broadly phrased purposes clauses in corporate charters so as to limit the constraining effect of the static charter fidelity norm. They could also draft charter provisions explicitly stating that directors can deploy existing assets to advance newly amended charitable purposes. Under these circumstances, donors presumed to be aware of these provisions would have no legitimate basis for believing that their donations will be used to further any particular charitable purpose or mission. All of these charter provisions should be enforceable,²³⁷ which would undermine the reliance-based equity argument used to justify static obedience norms.

Furthermore, adopting the historic mission fidelity norm as applied to directors of nonprofit charitable corporations would be doctrinally suspect. The historic mission fidelity norm traditionally has not been imposed on trustees of charitable trusts independently of the static charter fidelity norm.²³⁸ Declining to shackle trustees of charitable trusts with this norm while at the same time imposing it on directors of nonprofit corporations (who oversee a form of entity that, if anything, is usually thought to avoid some of the rigidities of the law of charitable trusts) creates incoherence.²³⁹ A possible response to this line of reasoning is that a single settlor of a charitable trust has only herself to blame for failing to articulate a precise charitable mission, whereas the multitudinous donors to a charitable corporation operating perpetually have no ability to draft charter purposes. But this objection is largely illusory. Rejecting the static charter fidelity norm and the historic mission fidelity norm in the case of charitable nonprofit corporations does not leave donors without protections analogous to those enjoyed by the settlor of a charitable trust. Donors of charitable corporations are still free to protect their donations from diversion to an alternative charitable use in the future by explicitly restricting their gifts when

236. Granted, funding realities may constrain this strategic behavior to some degree. If a charity anticipated that drafting its corporate charter to maximize its flexibility in redeploying donations would dramatically curtail its current receipt of donations, it would likely exercise self-restraint in drafting charter terms. See Gary, *Trust Law*, *supra* note 8, at 616 (“As a practical matter, to be able to attract future gifts from the same donors or from other donors, the charity must not stray far from its mission and must manage its assets effectively.”).

237. Cf. *Denckla v. Indep. Found.*, 181 A.2d 78, 83 (Del. Ch. 1962) (“If the power to make the contested grant is either expressly or by necessary implication given by its charter then it matters not whether trust law or corporate law is applicable.”), *aff’d*, 193 A.2d 538 (Del. 1963).

238. See *supra* Part I.D. (“[A] state that has adopted the static charter fidelity norm need not necessarily adopt the historic mission fidelity norm.”).

239. See Greaney & Boozang, *supra* note 8, at 58–59 (“That corporate law governs directors’ fiduciary duties, but trust law would govern their power to manage charitable assets, makes little sense doctrinally or analytically.”).

made.²⁴⁰ The law generally honors such restrictions.²⁴¹ Consequently, donors who wish to bind charitable donees to fulfill their expectations can do so.

Additionally, rejecting the static obedience norms in the case of charitable corporations does not disregard donor expectations altogether. It is possible to disfavor a system requiring *ex ante*, substantive governmental approval of a change in a charitable corporation's purpose or mission while embracing a system that provides for meaningful *ex post* judicial review of fiduciary decisions to change purposes or mission. A variety of approaches short of *ex ante*, substantive governmental approval would balance the reliance interest of donors and the desirability of vesting in nonprofit directors the primary responsibility for altering a charitable corporation's course.²⁴²

Finally, the basic charity advancement norm and its negative corollary protect the most compelling reliance interest of donors and other stakeholders. Although it is debatable whether a charitable corporation's donors should assume that the donee will not unilaterally alter its charitable purposes or mission, donors surely are entitled to assume that the donee will not divert funds to a *non-charitable* purpose. Such diversion would plainly violate donors' expectations. Fiduciaries who comply with the fundamental charity advancement norm and its negative corollary honor this reasonable expectation of donors. Thus, once again, rejecting static obedience norms does not require rejecting all reliance interests of donors.

C. Efficiency

One may also attempt to justify obedience norms on grounds of efficiency.²⁴³ The charity advancement norm is limited in the degree to which it promotes efficiency because compliance with the norm merely means that fiduciaries are furthering some charitable purpose, not that they are doing so effectively.²⁴⁴

240. See Sugin, *supra* note 8, at 898 (noting that those administering charities must administer their assets consistent with the donor's stated wishes); see also Marion R. Fremond-Smith, *The Search for Greater Accountability of Nonprofit Organizations: Recent Legal Developments and Proposals for Change*, 76 *FORDHAM L. REV.* 609, 620–22 (2007) (discussing donors' rights to enforce the terms of restricted gifts made to corporate charities).

241. See Sugin, *supra* note 8, at 914 (“Without additional legal protections, donors have tremendous power under contract law [to protect their interests], as they define the terms of their gifts.”).

242. See *infra* Part V (discussing several approaches).

243. See Buckles, *supra* note 20, at 217–19. I previously articulated two versions of the efficiency argument: reliance-based efficiency and experience-based efficiency. Because the latter version is quite weak for reasons already explained, I focus on the former version of the argument in this Article. For a discussion (and rejection) of the possible efficiencies of trust law parallelism in the context of unrestricted charitable gifts to corporate charities, see Katz, *supra* note 8, at 717–18.

244. This explains why the public benefit justification for obedience norms is distinct from the efficiency justification. To claim that furthering charitable purposes produces a public benefit does not imply that advancing the precise charitable purposes in question maximizes public benefit. This Article characterizes justifications for obedience norms that are articulated in terms of maximizing

Charter fidelity norms may promote efficiency by educating and reminding charity fiduciaries to adhere to the charity advancement norm and its negative corollary. Moreover, requiring some form of mission fidelity is also likely to be efficient, insofar as requiring governance in accordance with the charity's mission encourages fiduciaries to deliberate and weigh possible goals and achievable outcomes, rather than merely supervise random acts of kindness.²⁴⁵ However, the dynamic charter and mission fidelity norms would serve these functions just as well as the static norms. Furthermore, there are valid reasons to believe that static obedience norms, on balance, are probably less efficient than dynamic norms in the case of charitable corporations.²⁴⁶

Short-term efficiency is better served by imposing dynamic norms in some contexts.²⁴⁷ To illustrate, consider a cash-rich charity organized to fund the neutering of stray cats in Louisiana cities. Assume a hurricane blasts through the Gulf of Mexico and leaves thousands homeless in New Orleans. The social welfare produced by helping homeless human hurricane victims surely outweighs that of neutering the (now drastically diminished) feline population. However, the static charter fidelity norm and the historic mission fidelity norm would limit the charity's ability to quickly alleviate widespread human suffering because of the inevitable delay caused by the requirement mandating that the charity obtain *ex ante* government approval of the change in charitable purpose.²⁴⁸

The efficiency of requiring *ex ante* substantive governmental approval of changes in charter purpose and mission that are less time sensitive depends on many factors, including the out-of-pocket costs of such a system, the relative competence of charity fiduciaries and government agents in exercising judgment, and the long-term effect of the choice of the system on charitable donations.²⁴⁹

The costs associated with the first factor, out-of-pocket costs of obtaining *ex ante* substantive governmental approval to change the charter purpose or mission, are likely higher than the costs of a system that does not require such

public benefit, or at least better enhancing public benefit than other norms, net of associated costs, as justifications grounded in efficiency.

245. See Greaney & Boozang, *supra* note 8, at 84 (stating that "mission factors may help give content to the inchoate considerations that contribute to the board's deliberation"); Sugin, *supra* note 8, at 921 ("This is how care and obedience come together—the board must exercise care in evaluating the charitable goals and effectiveness of the organization.").

246. See Buckles, *supra* note 20, at 217.

247. Cf. Atkinson, *supra* note 14, at 87 (arguing that freeing fiduciaries from the obligation to advance purposes favored by "dead donors" enables them to "respond to evolving social needs in a more efficient and creative fashion"); Brody, *Whose Public?*, *supra* note 8, at 960 ("Blind obedience to mission . . . can impede the rational use of nonprofit corporate assets.").

248. Even adoption of the dynamic charter fidelity norm would delay the charity's response time to a lesser degree.

249. For a preliminary assessment of the argument that efficiency is enhanced when donors can rely upon static fidelity norms, see Buckles, *supra* note 20, at 217–18.

approval. Government actors will likely review fewer changes in a system that does not require *ex ante* substantive government approval.²⁵⁰ No credible argument can be made that requiring a governmental actor to review and evaluate every change in charter purpose or mission by every charity is cheap. Furthermore, other costs must be considered. For example, nonprofits seeking to alter their charitable paths will incur advocacy costs.

Concerning the second factor, there is no readily apparent reason to assume that charity fiduciaries are less able than government actors to decide upon the advisability of a change in purpose or mission. First, government approval of an entity's choice of charitable purpose and mission is generally not required when forming a charitable entity or drafting its initial mission statement. If the law assumes that private actors can be entrusted with the choice of an entity's original charitable purpose and mission, why should the law not assume likewise when fiduciaries decide upon a new charitable direction? In addition, the law generally assumes that charity fiduciaries are competent to make decisions. A governing board is not usually required to seek advance state approval to enlarge its facilities, double its workforce, expand its customer base, relocate, obtain a loan, or radically alter its investment portfolio.²⁵¹ If fiduciaries are assumed to be capable of making these changes, why should the law not assume that they are also capable of deciding upon changes in purpose and mission? Third, it may be assumed that those most familiar with the past and present operations of a charity are in the best position to evaluate the merits of a change in the charity's direction. Indeed, the ability of a board to manage a charity largely free from governmental meddling is a hallmark of the nonprofit sector.²⁵² If a governing board keeps itself informed as required by the duty of care,²⁵³ the board is probably at least as familiar with its operations as is a government actor, whose knowledge of the entity may be short-lived and limited to the contents of a file that is but one of hundreds the actor is responsible for reviewing.²⁵⁴ Further,

250. There is a plausible system of *ex post* review of charter and mission changes by government actors that is just as comprehensive and costly as one requiring *ex ante* review of such changes. However, such attributes of a system providing for *ex post* review of fiduciary decisions seem improbable. In a system requiring *ex ante* approval, every change in the purposes or mission of every charity theoretically requires governmental review and an assessment of its merits. In a system of *ex post* review, a governmental actor, such as a state attorney general, would be expected to focus attention on changes in purpose or mission that seem most problematic.

251. *Cf.* CAL. CORP. CODE § 5210 (West 2013) (stating that all powers of a nonprofit corporation must be "exercised by or under the direction of the board [of directors]"); TEX BUS. ORGS. CODE ANN. § 22.201 (West 2012) (stating that the board of directors manages a nonprofit corporation's affairs).

252. Fremont-Smith, *supra* note 16, at 1–2. *Cf.* Reiser, *supra* note 47, at 14 ("[R]eliance on public enforcement of charitable mission would seriously threaten charitable autonomy and perhaps infringe on associational rights.").

253. *See, e.g.*, REVISED MODEL NONPROFIT CORP. ACT. § 8.30(a) cmt. 2 (1987) (explaining that pursuant to their duty of care, directors must act with "informed judgment").

254. *See* Brody, *Whose Public?*, *supra* note 8, at 976 ("The courts . . . have no particular familiarity, much less expertise, with the charity's operating needs."); *id.* at 977 ("[S]tate attorneys

government actors who serve limited terms in positions that render them directly or indirectly accountable to the electorate (especially state attorneys general) may adhere to a concept of “public benefit” that is more parochial, and therefore less objective, than that of charity fiduciaries.²⁵⁵

With respect to the third factor, the long-term effect of the choice of the system on charitable donations, a distinction between charitable trusts and charitable corporations is once again apropos.²⁵⁶ A single settlor of a charitable trust may choose the trust form to maximize the probability that her charitable preferences will be honored in perpetuity.²⁵⁷ Without meaningful assurances that the static charter fidelity norm will broadly apply over time, some prospective settlors may simply decide not to fund charitable trusts. For the class of such settlors, generally imposing the static charter fidelity norm on trustees may increase efficiency by encouraging the initial funding of charitable trusts.²⁵⁸

Similarly, with respect to nonprofit charitable corporations, people may decrease their donations to corporate charities if they can alter their charitable purposes and use donations to advance new causes that donors did not initially intend to support.²⁵⁹ Without assurances that donations will be spent as contemplated by donors, some donors may not subsidize worthy projects as extensively as they otherwise would.²⁶⁰ The reduction in donations is inefficient because it results in an undersupply of those charitable goods deemed most efficient by the market for donations. However, this efficiency argument is far from convincing.²⁶¹ In brief, (1) it is unclear that those who donate to charitable nonprofit corporations really assume or prefer the existence of static fiduciary

general have no necessary expertise, much less the resources, to address the myriad concerns of the hundreds of thousands of charities that function in the United States today.”).

255. *See id.* at 939 (“When faced with the flight or loss of significant nonprofit assets from a locality, state regulators, courts, and the legislature sometimes mobilize to secure the border.”). *Cf.* Atkinson, *supra* note 14, at 95 (arguing that elected public officials may cater to powerful political constituencies, rather than those most deserving of charitable funds); Brody, *Whose Public?*, *supra* note 8, at 947–48 (observing the political realities facing elected attorneys general).

256. *See Oberly v. Kirby*, 592 A.2d 445, 466–67 (Del. 1991) (contrasting the probable expectations of the settlor of a charitable trust and the founder of a charitable corporation).

257. *Cf. Manne*, *supra* note 8, at 271 (arguing that upholding a founder’s intent encourages the formation and funding of charities).

258. This observation does not imply that, on balance, imposing the static charter fidelity norm on trustees of charitable trusts necessarily is efficient given the costs of doing so. Instead, it simply acknowledges the plausibility of the position that applying the static charter fidelity norm to trustees of charitable trusts likely encourages some settlors to give.

259. For an initial exposition and preliminary response to this argument, see Buckles, *supra* note 20, at 217–18.

260. Frost, *supra* note 8, at 951.

261. *See* Buckles, *supra* note 20, at 217–18 (criticizing the reliance-based efficiency justification for obedience norms).

obedience norms;²⁶² (2) the costs of a system requiring ex ante, substantive government approval of purpose/mission changes may outweigh the benefits of such a system, not only in fact, but also as perceived by donors; and (3) donors who desire to protect themselves against redirection of charitable donations can do so by restricting their charitable gifts.²⁶³ On balance, the static obedience norms are not easily justified on grounds of efficiency in the case of charitable corporations.

D. Summary

Ensuring at least some public benefit is the most justifiable purpose of fiduciary obedience norms. The charity advancement norm and its negative corollary—and generally the legality norm—plainly serve this purpose and should apply to all charity fiduciaries. Reliance-based equity may also justify certain obedience norms, most clearly the charity advancement norm and its negative corollary. Equity concerns probably do not justify any static obedience norm as applied to the management of unrestricted gifts to charitable corporations. Similarly, although imposing some form of charter fidelity and mission fidelity norms may promote efficiency, it is doubtful that applying static obedience norms to directors of nonprofit charitable corporations does so. The dynamic charter fidelity and dynamic mission fidelity norms, however, should apply to these directors. Efficiency justifications may or may not support imposing the static charter fidelity norm on trustees of charitable trusts,²⁶⁴ but there is no obvious reason to bind them to the historic mission fidelity norm when trust purposes are broadly phrased. Nonetheless, if a charitable trust has broadly phrased purposes, holding its trustees to the dynamic mission fidelity norm would likely enhance efficiency.

V. IMPLEMENTING FIDUCIARY OBEDIENCE NORMS

Evaluating the possible purposes of obedience norms informs the determination of what norms should apply to whom. With the conclusions of Part IV in mind, the legal analyst is poised to ask a series of questions ultimately designed to help judges and legislators formulate a cogent legal framework for implementing fiduciary obedience norms. Articulating these distinct questions not only aids the analysis, but may also help establish common ground among courts and commentators that currently hold divergent views.

The following questions should be answered in crafting an approach for imposing obedience norms on charity fiduciaries:

262. See Atkinson, *supra* note 14, at 81 (stating that donors to charitable corporations may prefer “fiduciary freedom to change purposes,” or at least harbor indifference to such freedom).

263. See Buckles, *supra* note 20, at 218.

264. See *supra* note 228 and accompanying text (noting that the equity justification for imposing the static charter fidelity norm on trustees of charitable trusts would vanish should the law abandon the traditional doctrine of cy pres and decline to replace it with some similar alternative).

- (1) Should charity fiduciaries have the power to alter a charity's purposes or mission (and devote assets accordingly) without obtaining ex ante, substantive governmental approval of the change?
- (2) If charity fiduciaries should have the power to alter a charity's purposes or mission (and devote assets accordingly) without obtaining ex ante, substantive governmental approval of the change, should their exercise of discretion nonetheless be subject to governmental review?
- (3) If the decision by charity fiduciaries to change a charity's purposes or mission (and devote assets accordingly) is reviewable either ex ante or ex post, how much deference should a reviewing governmental agent extend to charity fiduciaries?
- (4) If the decision by charity fiduciaries to change a charity's purposes or mission (and devote assets accordingly) is reviewable either ex ante or ex post, what grounds justify the decision of charity fiduciaries to change a charity's purposes/mission?

Concerning the first question, the analysis of Part IV of this Article suggests the propriety of maintaining a distinction between charitable corporations and charitable trusts.²⁶⁵ Part IV supports the view that directors of charitable nonprofit corporations should not be governed by static fiduciary obedience norms (except with respect to restricted gifts).²⁶⁶ As applied to corporate fiduciaries, the public benefit, equity, and efficiency arguments probably do not justify the static norms. In the case of trustees of charitable trusts, reliance-based efficiency concerns may support imposition of the static charter fidelity norm, but neither equity nor efficiency considerations justify applying the historic mission fidelity norm as an independent constraint.

At this point, those who have argued for imposing static fiduciary obedience norms on all charity fiduciaries may take heart that rejecting certain static obedience norms does not end the relevant inquiries. To conclude that directors of charitable corporations should have the *power* to alter a charity's purposes and mission, and to devote corporate assets accordingly, does not establish that doing so is a proper exercise of fiduciary discretion in any given case.²⁶⁷ Similarly, that trustees of charitable trusts with broad purposes clauses should have the power to alter their charitable missions does not mean that every mission change that falls within such purposes is prudent. Although in each case fiduciaries should have the power to change charitable paths without first obtaining governmental blessing for their decisions, their exercise of discretion

265. See *supra* text accompanying notes 302–04.

266. Thus, the analysis generally favors the approach taken by the PLNO and the court in *Bethany Medical Center Inc.*, rather than the approach taken by the court in *Manhattan Eye*. Compare *supra* Part III.B.3.c., with *supra* Part III.B.3.b.

267. Consider the following analogy to the management of an investment portfolio: that a board of directors has the power to authorize charity officers to invest in a hedge fund does not mean that it is prudent for the board to do so every time a hedge fund promoter pitches an investment to the charity. Power must not be confused with prudence.

nonetheless should be subject to governmental review, most logically, judicial review.²⁶⁸ Doing so treats their decisions regarding purposes and mission similarly to how the law treats other decisions that they make. Although the primary responsibility for adopting and amending charitable goals rests with charity fiduciaries, they should not be free to act irresponsibly in overseeing a change in a charity's purposes and mission, just as they are not free to act irresponsibly in overseeing a change in the charity's pool of investments or employees. An attorney general should be able to question a decision to alter charitable purposes and mission, once made, just as she may question other decisions of charity fiduciaries.

Ultimately, two questions persist. The primary purpose of articulating these last two questions is not to answer them here, but to suggest how courts and state legislatures should think through the issues in order to answer them. As to the penultimate question, those convinced that charity directors and trustees are uniquely well suited to assess the merits of changes in purposes and mission may favor one of two standards of judicial review. One standard would accord heightened deference to charity managers, perhaps by authorizing courts to find a violation of fiduciary duty only when managers have acted arbitrarily and capriciously. Those who see no real difference between a fiduciary's judgment concerning charitable purposes and mission and that concerning any other matter may favor another approach to judicial review, one that evaluates all disinterested exercises of fiduciary discretion under the same standard.²⁶⁹ Those who desire heightened protection of the reliance interests of donors and other stakeholders might favor a standard of judicial review that places an affirmative burden on charity fiduciaries to establish the justification for a change in purposes or mission.²⁷⁰

Although the issue of what standard of judicial review should apply in these cases is theoretically distinct from the issue of whether such review should be *ex ante* or *ex post*, a standard of judicial review that accords some deference to the judgment of fiduciaries appears to be consistent with the assumptions that

268. See Greaney & Boozang, *supra* note 8, at 84 (advocating for the imposition of a duty on directors of charitable corporations to consider charitable mission, subject to deferential judicial review).

269. Most decisions of directors of incorporated charities are subject to the business judgment rule. See, e.g., PRINCIPLES OF THE LAW OF NONPROFIT ORGS. § 365 (explaining the business judgment rule); Goldschmid, *supra* note 8, at 644 & n.76 (citing cases that have applied the business judgment rule to directors' decisions).

270. Additional protection of donors' reliance interests could take the form of requiring a charitable corporation to notify the state attorney general of a proposed charter amendment or other significant change. The attorney general could then petition a court for an injunction if he or she believes the change is improper. Such an approach approximates adoption of the static or historic fidelity norms, insofar as a governmental actor (the state attorney general) functionally has the power through adjudication to ensure that a change will become effective only if another governmental actor, a court, permits it. Some states essentially follow this approach in certain contexts. See, e.g., CAL. CORP. CODE § 5913 (West 2013) (requiring notice to the Attorney General before a public benefit corporation disposes of substantially all of its assets).

would lead one to favor dynamic obedience norms over static norms.²⁷¹ The argument for applying dynamic obedience norms to directors of charitable corporations ultimately implies that charitable boards are better suited than courts and attorneys general to monitor and redirect charitable paths. If that premise is correct, some degree of judicial deference to the decisions of directors is warranted.

Concerning the final question, state law should articulate the grounds that justify the decision of charity fiduciaries to change a charity's purposes and mission, regardless of the standard of judicial review that is applied or whether such review is performed *ex ante* or *ex post*. The choice of grounds for justifying a change in purposes and mission is theoretically distinct from the decision of whether to implement *ex ante* or *ex post* judicial review of the change. Nonetheless, the two issues are intertwined. Those who favor static norms will likely desire to limit the grounds for changing a charity's purposes and mission,²⁷² whereas those who favor dynamic norms will likely advocate for broader grounds justifying change.²⁷³

To illustrate, the doctrine of *cy pres*, which governs charitable trusts, embraces quite narrow grounds for changing charitable purposes,²⁷⁴ an unsurprising reality if one observes that the static charter fidelity norm governs charitable trusts.²⁷⁵ But if one is persuaded by the argument of Part IV that dynamic obedience norms should govern directors of charitable corporations, one should embrace a broader set of grounds for altering a corporate charity's purposes and mission and consequent deployment of assets than those recognized by the doctrine of *cy pres*. Relevant facts include (1) inefficiencies in maintaining the status quo (high operating costs, difficulty in retaining competent personnel, inability to maintain adequate facilities, etc.); (2) the ability of other institutions (government, nonprofits, and for-profit firms) to serve the community previously served by the charity desiring to change course;

271. Cf. Greaney & Boozang, *supra* note 8, at 83 (proposing that directors "enjoy presumptive deference in defining and, within limits, amending" charitable mission); Sugin, *supra* note 8, at 921 (arguing in favor of a concept of dynamic mission fidelity under which "judicial review [is] highly deferential to the reasoned decisions of charity boards").

272. The grounds inhering in the "quasi-*cy pres*" approach applicable to dissolving New York charitable corporations provide an example. See, e.g., *In re Multiple Sclerosis Serv. Org. of N.Y., Inc.*, 496 N.E.2d 861, 864 (N.Y. 1986) (reversing an intermediate appellate court that permitted a dissolving charitable corporation to donate part of its assets to another charity that did not meet New York's statutory requirements).

273. See, e.g., Greaney & Boozang, *supra* note 8, at 83–84 (listing relevant mission-related factors); Sugin, *supra* note 8, at 921 ("Obedience as fidelity empowers boards to exercise their judgment in the name of mission by allowing them to depart from business law constraints.").

274. See *supra* Part II.B.2.

275. This observation does not imply that existing charitable trust law strikes the optimal balance between honoring donors' reliance interests and enabling trustees to manage charitable trusts efficiently. The law could still protect the reliance interests of donors to some degree by coupling *ex ante* judicial review of proposed amendments to a trust instrument with expanded grounds for changing charitable purposes.

(3) the importance of the needs that would be met with the change in purpose relative to the needs currently being met; (4) the ability of other institutions to meet the needs that would be addressed with the change in purpose; and (5) the efficiency with which the charity could pursue the new purpose.²⁷⁶

Although these factors bear upon the reasonableness of a decision to change a charity's purposes, it is most important to emphasize (1) that the law must be clear, so that both fiduciaries and governmental actors know what is expected of charity fiduciaries, and (2) that the adoption of dynamic obedience norms suggests a measure of confidence in the decision-making capacity of fiduciaries, confidence that implies their ability to evaluate all of the relevant facts. Courts and legislatures should keep these points in mind as they impose obedience norms on charity fiduciaries.

VI. CONCLUSION AND IMPLICATIONS

The law of obedience norms governing charity fiduciaries is far from settled and coherent. State laws embrace the legality norm and the charity advancement norm, and some form of charter fidelity norm. The static charter fidelity norm governs charitable trusts by default. Many states appear to accept the dynamic charter fidelity norm as applied strictly to the formal requirements for amending a charitable corporation's articles of incorporation. However, states differ in the constraints that they impose on corporate directors seeking to deploy charitable assets for purposes other than those traditionally served by their charities. Some states clearly implement the static charter fidelity norm in these contexts, whereas others favor the dynamic charter fidelity norm. The law is ordinarily unclear as to whether charity fiduciaries must advance a charitable mission more specific than its charter purpose(s).

An analysis of the potential justifications for obedience norms affirms the legitimacy of the charity advancement norm and its negative corollary, as well as (in general) the legality norm. The efficiency justifications for broadly imposing the static charter fidelity norm on trustees of charitable trusts are plausible, though not definitive. However, dynamic charter fidelity norms should apply to directors of charitable corporations. The historic mission fidelity norm, as a norm independent of charter fidelity, should not apply to charity fiduciaries. Rather, imposing the dynamic mission fidelity norm on all charity fiduciaries, both directors and trustees, is sensible.

Deciding what norms should govern which charity fiduciaries does not complete the necessary analysis. States must also decide the degree of deference that courts should extend to the decisions of charity fiduciaries, and must determine the grounds that justify a decision by charity fiduciaries to change a charity's purposes and mission. This Article suggests how states should approach these design questions.

276. This list is not exhaustive, but is representative of the factors that boards should consider when deciding upon a change in charitable purpose and mission.

This Article does not focus on whether the law's implementation of obedience norms should occur through imposition of a "duty of obedience" on directors of charitable nonprofit corporations, in addition to the duties of care and loyalty. Nevertheless, this Article's analysis suggests that the tentative draft of the PLNO strikes the proper balance by recognizing the legitimacy of certain obedience norms, yet declining to articulate a distinct "duty of obedience" governing charity fiduciaries. The dynamic charter fidelity norm and the dynamic mission fidelity norm are best implemented in a system that confers on charity fiduciaries both primary responsibility for forging a charity's path and discretion in how best to do so. The twin fiduciary duties of care and loyalty, exercised in good faith, provide sufficient standards for evaluating directors' decisions under such a system. To impose an additional "duty of obedience" on directors arguably implies that decisions concerning mission and purpose are somehow much different from other exercises of discretion. It is doubtful that they are, and therefore the more traditional expression of fiduciary duties should be favored.