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**Congressional Roundtable on College Endowments –
Restricted Gifts Testimony**

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Roundtable on College Endowments and College Affordability
Sponsored by Senator Charles Grassley and Congressman Peter Welch
Senate Finance Committee Hearing Room, Dirksen Office Building
September 8, 2008

Panel 2: What is an Endowment?

Remarks by Iris Goodwin, Associate Professor, University of Tennessee College of Law

Restricted Gifts

Restricted purpose gifts potentially bear upon that portion of the university's endowment that can be used toward undergraduate financial aid and other tuition relief. I am going to describe what a restricted gift is, the requirement under state common law that such restrictions obtain in perpetuity, the grounds for relief under the common law, and the grounds for relief and other relevant provisions of UPMIFA. The provisions of UPMIFA that are applicable to restricted gifts were drafted against the background of the common law doctrine and under UPMIFA common law relief is still available.

Restricted Gift: The Legal Term

A restricted or special purpose gift is a gift given with one or more conditions attached. These conditions typically specify a purpose for which the donor requires the gift be applied once it is in the hands of the university. The classic restricted purpose gift endows some particular project or program. Examples would include gifts to support the women's basketball team or, more broadly, women's athletics; or a gift to support a particular college or program – the law school or the Russian language program; or a gift for the purpose of maintaining the stained glass windows in the university chapel. Gifts can also be restricted as to the management or investment of funds and as to the application of income or principal to the specified purpose. In all events, however, a restriction attached to a gift requires that the university or other charitable organization segregate the donated funds in its financial records and employ them only in ways consistent with the donor's specifications.

Once the university accepts a restricted gift, the university becomes subject to a Draconian rule. Not only must the university use the gift consistently with the donor's specifications, but the restriction obtains in perpetuity (or until the subject funds are exhausted). While many interests in the law must terminate in some finite period of time, there is an exception under state common law for interests that are charitable. In the same way a charitable organization can go on forever, so restrictions placed on the use of donated funds also last forever.

Relief under the Common Law

The *cy pres* doctrine. The *cy pres* doctrine applies to gifts that are restricted as to projects and purposes. A university that would like to free such funds for other projects and purposes or simply take an existing program in a new (and more timely) direction must approach a court of equity, asking it to modify the restriction under the narrow doctrine of *cy pres comme possible*.¹ Courts have historically granted *cy pres* relief only where the organization can demonstrate that the restriction adhering to the particular funds has become “impossible,” “impracticable,” or “illegal” to fulfill.²

Relief is typically granted on grounds of “impossibility” only where the cause to which funds are to be applied has ceased to exist. The disease has been cured or the societal ill to be remedied has been eliminated.³ If “impossibility” provides relief only on a narrow set of grounds, however, “impracticability,” as interpreted by the courts, is equally unyielding. According to the second Restatement of Trusts, a purpose has become “impracticable” when it appears that “under the circumstances the application of the property to the designated purpose would fail to accomplish the ... intention of the [donor].” The criterion of “impracticability” effectively dissolves into “impossibility,” with courts unwilling to exploit the category otherwise. “Illegality” as a criterion of relief is applied almost entirely to set aside restrictions that are discriminatory with respect to race, gender, and sometimes religion.⁴

Recently, the grounds for *cy pres* relief have seen a modest expansion under both the Uniform Trust Code⁵ and the Restatement (Third) of Trusts,⁶ with the addition of a fourth criterion, “wasteful,” to the historic triad of grounds. With respect to a restrictive grant, “waste” allows for an assessment of the adequacy of the funding relative to the mission and, where such funding far exceeds the requirements of the specified mission, affords relief under the *cy pres* doctrine.⁷

We should also note that the university has a second legal hurdle under the *cy pres* doctrine. The university must also demonstrate that the donor in making the restricted

¹ A Norman French phrase meaning “as near as possible.” GEORGE GLEASON BOGERT, GEORGE TAYLOR BOGERT & AMY MORRIS HESS, *THE LAW OF TRUSTS AND TRUSTEES* § 431 (Rev. 2d ed. 2003).

² See *RESTATEMENT (SECOND) OF TRUSTS* § 399 (1959).

³ See, e.g., *Jackson v. Phillips*, 96 Mass. 539 (1867) (*cy pres* relief granted after the Emancipation Proclamation when testator had left funds to produce books, newspapers, and speeches to influence public sentiment to end slavery in the United States).

⁴ *RESTATEMENT (SECOND) OF TRUSTS* § 399 (1959).

⁵ Section 413(a).

⁶ *Restatement (Third) of Trusts* section 67 (2003).

⁷ Commentators developed the criterion of “waste” in the wake of the holding in *Estate of Buck*, Superior Court of Marin County, California, 1986, which denied *cy pres* relief to trustees of a restricted grant that had seen astronomical increase in value after the death of the donor. See *Estate of Buck*, 35 Cal. Rptr. 2d 442, 442-43 (Cal. App. 1994). The grant was restricted to the purpose of providing “care for the needy of Marin County,” one of the wealthiest counties in the United States, based upon per capita income. *Estate of Buck*, 35 Cal. Rptr. 2d at 443. The court refused to grant relief under the traditional common law standard of impossibility, impracticability or illegality. *Id.*; See John G. Simon, *American Philanthropy and the Buck Trust*, 21 U.S.F. L. REV. 641 (1987).

gift did not have a narrow, specific charitable goal, but rather had a broader purpose – a “general charitable intent,” notwithstanding the restrictive language in the grant. There is a movement afoot to eliminate this requirement for *cy pres* relief, but this element is by no means gone.⁸

If the requirements for relief can be met, the relief granted is quite limited. Even if an organization can meet its burden under the law, *cy pres* relief is by its very nature modest.⁹ Equity permits the organization to substitute another charitable object, but only one that approaches the donor’s original purpose as closely as possible – thus the name for the proceeding, *cy pres*.

Administrative Deviation. Gifts can also be restricted as to the management or investment of funds and as to the application of income or principal to the specified purpose. Under state common law, relief from such administrative or procedural provisions of a gift can be granted under the doctrine of administrative deviation, a doctrine closely allied to *cy pres*. Under the common law, a court can alter the administrative or procedural provisions of a gift when “it appears to the court that compliance is impossible or illegal, or that owing to circumstances not known to the [donor] and not anticipated by him compliance would defeat or substantially impair the accomplishment of the purposes of the [gift].”¹⁰ Strictly speaking, however, in applying the doctrine of deviation a court cannot change the original charitable objective of a donor or divert the gift to a purpose different from the purpose set forth in the donative instrument.¹¹

Relief under UPMIFA

Donor Release. The Uniform Prudent Management of Institutional Funds Act (UPMIFA) allows a charity a complete or partial release where it can obtain the consent of the donor. The donor’s consent obviates the need to apply to court and can release a fund both where the purpose of the fund is restricted as well as where the fund is restricted as to its management or investment.¹² Note that the donor cannot redirect the property to another use by the charity. If, however, the charity cannot obtain the donor’s consent (whether because the donor is dead, disabled, or unavailable, because the donor cannot be identified, or because she simply withholds consent), the organization may seek *cy pres* relief or administrative deviation, depending upon the type of restriction at issue.

⁸ Both the Uniform Trust Code and the Restatement (Third) have moved to lower (if not eliminate) this legal hurdle for the charity by creating a legal presumption of general charitable intent with respect to any restricted gift, thereby shifting the burden to the party opposing the application of *cy pres* to show that the donor’s intent was entirely limited to the purpose stated in the grant.

⁹ AUSTIN W. SCOTT, THE LAW OF TRUSTS § 399 (4th ed. 1988) (stating presence of valid gift over makes *cy pres* inapplicable when charitable trust fails).

¹⁰ RESTATEMENT (SECOND) OF TRUSTS § 381.

¹¹ *Id.* at 341.

¹² UPMIFA Section 6(a).

This provision allowing a donor to release her restriction is carried over from the earlier Uniform Management of Institutional Funds Act (UMIFA) and constitutes an advance over the common law. There a donor's consent is not effective to release restrictive language unless the donor has retained an express reversion. This is because, absent a reversion, the donor has no standing to sue with respect to the restriction. Indeed, even if the donor has retained a reversion, it is not clear under the common law that the donor can release the restriction without the consent of the state attorney general, the enforcer of charitable gifts. Under UPMIFA the donor need retain no such interest in the property.

What UPMIFA adds to UMIFA is a clarification with respect to the application of *cy pres* and administrative deviation. While UMIFA did not – in the words of the statute – “limit the application of the doctrine of *cy pres*,” UMIFA appeared to permit only a release from a restriction but not a judicial modification. UPMIFA makes clear that the charity retains the avenue of common law *cy pres* relief (under Section 6(c)¹³) and indeed of administrative deviation (under Section 6(b)¹⁴), both independent of seeking a release from the donor and in the event that the donor is not available or forthcoming.

Modification by Charitable Organization. Probably the most significant addition under UPMIFA is the provision which allows the charity to modify a restriction on a fund that is both old and small – that is, one that has a value of less than \$25,000 and was established by the donor more than 20 years ago. For funds such as these, the expense of a trip to court is often prohibitive, so that such funds tend to sit dormant, unavailable for any charitable use. Notice to the donor is not required. Even with respect to these small, old funds, however, the charity must notify the state attorney general of the intended action. If the attorney general objects to the proposed action, she can seek the agreement of the charity to change or abandon the modification and, if that fails, she can commence a court action to enjoin it. Thus, as under state law, the attorney general is the protector both of donor intent and of the public's interest in charitable funds.¹⁵

Caveats under UPMIFA

Donor Intent Ascendant. Under UPMIFA, donor intent remains ascendant. When a donor expresses intent clearly in a written gift instrument, the statute requires the charity follow the donor's instructions, absent cause for relief as provided. And in the provisions

¹³ UPMIFA Section 6(c) provides that where a particular purpose becomes unlawful, impracticable, impossible to achieve, or wasteful, a court may modify the purpose of the fund in a manner consistent with the charitable purpose expressed in the gift instrument. The charity must notify the state attorney general who must be given an opportunity to be heard. Note that UPMIFA tracks the contemporary common law grounds of relief. Note also that there is no mention of the need to demonstrate general charitable intent.

¹⁴ Section 6(b) addresses restrictions applying to the management or investment of an institutional fund. A court can grant relief where the restriction is impracticable or wasteful, where it impairs the management or investment of the fund, or where, because of circumstances not anticipated by the donor, a modification of a restriction will further the purposes of the fund. The state attorney general gets notice of the application and opportunity to be heard. Note that this provision tracks the criteria for relief under common law administrative deviation.

¹⁵ UPMIFA Section 6(d).

including the actions for *cy pres* and deviation, UPMIFA requires an institution to seek modifications that are “in a manner consistent with the charitable purposes expressed in the gift instrument” for *cy pres* and “in accordance with the donor’s probable intention” for deviation. The goal remains to implement the donor’s intent.¹⁶

Charitable Corporations as well as Trusts. UPMIFA clarifies that the doctrines of *cy pres* and deviation apply to restricted funds held by nonprofit corporations as well as to restricted funds held by charitable trusts. The doctrines of *cy pres* and administrative deviation come into the law courtesy of the law of trusts. Accordingly, some have questioned whether these doctrines should be applicable to any charitable entity organized as a corporation – as many universities are. The common law answer has been that, whether the charity is formed as a corporation or as a trust, restricted gifts to a charitable entity are governed by the law of trusts. Even though courts have applied these rules drawn from the law of trusts to nonprofit corporations in the past, the UPMIFA Drafting Committee wanted to provide statutory authority for this application going forward.¹⁷

¹⁶ UPMIFA Section 4(a) and Prefatory Notes and Comments.

¹⁷ UPMIFA Prefatory Notes and Comments.