Memorandum

To: UMIFA Drafting Committee

From: Susan Gary, Reporter

Re: Discussion topics for the November 14-16 meeting

Date: October 20, 2003

At the committee meeting immediately preceding the NCCUSL Annual Meeting we made a few changes to the draft of UMIFA. The new draft, dated October 10, 2003, reflects those changes. The major changes in this draft are ones involving restructuring. We reordered several of the sections, and I have combined old sections 4 and 7. The act seems to flow more smoothly now, but we still have a number of issues to address.

This memo identifies discussion topics for our November meeting, based on our meeting in August and on comments we received from the floor. I have tried to include an explanation of the comments that have been made to date concerning these issues. In some cases I have identified the source of the suggestions or concerns, but in many cases the concern was a general one raised during our committee meeting. Please do not feel left out if your name does not appear, and I hope I have not attributed comments to anyone incorrectly.

I will also ask NCCUSL to mail you copies of letters from William Josephson, Assistant Attorney General in charge of the New York Charities Bureau, and Kathryn Longley, General Counsel for Texas Methodist Foundation.

Discussion Topics for November 2003 Meeting of the UMIFA Drafting Committee

Section 2. DEFINITIONS.

(2) Endowment fund. Does this include an endowment fund created by the Board of a charity? Once the Board creates an endowment fund, and assuming it does not accept new gifts to the fund, can the Board release the fund so that it will no longer be an endowment fund? Should the statute talk about board-designated endowment funds? These questions came from the floor.

(3) Gift instrument. What if a fund is 150 years old and there are no records? Should there be a presumption that a fund is an endowment fund if the charity has treated it as such? This question came from the floor.

(4) Institution. The changes in the definition were suggested by Jerry Bassett, our Style liason. He was concerned that our definition narrowed the scope, when what we

were trying to do was expand the scope of the section. The Comment can explain that we mean to include nonprofit corporations and trusts and that we understand that a trust is more correctly a relationship and not an entity.

(5) Institutional fund. Should the definition include state appropriations for universities? We discussed this without reaching a conclusion. If we decide to exclude such appropriations, can we so indicate in the Comment or do we need to state something directly in the statute?

The definition of institutional fund excludes programmatic investments. Barry Hawkins suggested that we add the word "primarily" to limit the exclusion to investments that are primarily programmatic. The concern is that a charity will argue that investments are programmatic to escape the rules of UMIFA, whether or not the investments are truly program-related investments. This concern also surfaced in comments from the floor, with speakers wondering about abuse and enforcement. John Langbein pointed out that the charitable purposes doctrine should protect against abuse.

Do we need a definition of "fund?" Does each gift with a restriction create a separate fund? Sandy Rae proposed the following definition: "Fund" means money or other property held by an institution for its exclusive use, benefit or purposes."

Split-interest trusts. The statute currently excludes charitable remainder trusts and charitable lead trusts. David English asked whether they should be included. The release and modification provisions of UMIFA would be useful for those trusts but would those powers cause problems under IRC § 664? Should pooled income funds be included? John Langbein argued that UMIFA is intended to deal with wholly charitable trusts and that the Uniform Trust Code is the appropriate place to deal with issues affecting trusts with private interests. UMIFA should touch trust law only when necessary. After discussion, there was no support for including split-interest trusts in UMIFA.

Section 3. DONOR INTENT.

We deleted the second sentence due to concerns about what evidence could be included. Evidence of donor intent based on multiple lunchtime conversations is not desirable. King Burnett suggested that the statute provide that other evidence can be considered if the language of the gift instrument is ambiguous. David English suggested using the standard of clear and convincing evidence required by UTC § 407 for oral trusts. Mary Jo Dively expressed concern that "determinations" by itself was too broad, so we added "investment and expenditure" to modify determinations.

Institutions, and not donors, create institutional funds, so the first sentence was changed. Is the new phrase "as contained in a gift instrument" too limiting, given our discussion of evidence that may be considered?

Should Section 3 include a cross-reference to Section 6, paragraph (c)?

Do we need Section 3 as a separate section? An argument in favor of including the separate section is that it states a controlling principle underlying the rest of the act. An argument against Section 3 is that the section does not add to existing law (the principle is already there) and that other sections adequately address the issue (Section 4, paragraph (b)(1), Section 5, and Section 6, paragraph (a)(1)). Shelly Kurtz thinks that having Section 3 as a separate statement of the importance of donor's intent will help with enactment.

Section 4. PRUDENT INVESTING AND MANAGING OF INSTITUTIONAL FUNDS.

The standard still is not right. In paragraph (b) we adopt the prudent investor standard, but in paragraph (a) we seem to be undercutting the standard by referring to the corporate and trust law standards. Mike DeLucia (NH Attorney General's office) prefers that we unambiguously adopt the trust law standard. The AG needs something to show the court and in his view the higher standard helped address his concern about the loss of historic dollar value as a floor.

King Burnett notes that the standard in (a) is not tied to managing institutional funds.

The revision deleted the reference to other law (It was in old Section 4, paragraph (b).) Do we need to include that as part of this section?

I have not yet revised the Comment to Section 4. Sections 4 and 7 were combined to become current Section 4, so two Comments now appear following Section 4. I will revise the Comment following the November meeting, after I have a better sense of what we want to say.

A question from the floor asked about investing standards if a fund did not want to invest in stock of companies whose purposes were at odds with the purpose of the charity. For example, a charity committed to children's issues might choose not to invest in tobacco companies. According to the Commissioner who spoke, in Alaska charities are chastised for not investing in tobacco and alcohol. The speaker would like to see some specific approval of a decision not to invest in companies whose purposes are contrary to those of the charity. Perhaps such a statement belongs in the Comment.

Section 6. EXPENDITURE OF ENDOWMENT FUNDS; RULE OF CONSTRUCTION.

Some committee observers remain concerned that without guidance boards will become paralyzed and unable to act. I heard the same comment from ACTEC lawyers at a June meeting. Janne Gallagher has proposed a process-based safe harbor that we should discuss at the November meeting.

The deletion in paragraph (1) came from the floor.

Section 8. RELEASE OR MODIFICATION OF RESTRICTIONS ON USE OR INVESTMENT.

Paragraph (a) applies to all institutional funds but paragraphs (b) and (c) apply to endowment funds. Is this correct?

Paragraph (a)(2). Someone from the floor suggested replacing "purposes of the fund" with "consistent with Section 7." (This would now read "consistent with Section 4.")

Paragraph (b). Small fund modification. This provision generated a lot of comment from the floor and from the committee. The amount, although bracketed, is of concern. $50,000 is a reasonable number when litigation costs are considered but a large number from the perspective of an individual donor. King Burnett recommends reducing the amount to $5,000 or deleting this provision. He thinks this paragraph as drafted will cause enactment problems.

The other big issue is whether notice to a living donor and notice to the Attorney General should be required. The AGs are likely to favor notice so that they can protect donors from charities. The concern from the floor was that if a donor is alive the donor should be consulted. The argument against notice to either a donor or the AG is that the purpose of this provision is to reduce costs to charities. Even if a charity needs to make a fairly straightforward modification, notifying the donor or the AG creates administrative costs. A charity may simply choose not to modify even if doing so results in inefficiencies, because the cost of AG involvement may be too great. John Langbein argued that notice to the AG is not needed because abuses tend to occur in the operation of charities rather than in the application of cy pres.

A comment from the floor recommended that modification under paragraph (b) be allowed only after the donor's death. The comment suggested adding the words "After the death of the donor" to the beginning of the paragraph.

There was consensus that notice beyond the original donor (to family, heirs, etc.) was not necessary or appropriate.

Concern about retroactive application of a provision that permits modification without notice to the donor was also expressed on the floor.

Paragraphs (b) and (c). The description of cy pres now corresponds to the language in UTC § 413 rather than the language from the Restatement. It seems appropriate to track the language in another uniform act. Using the UTC language allowed me to remove the split infinitive, which, alas, was my doing and was not directly from the Restatement.