

THE REGULATORY ROLE OF THE ATTORNEY GENERAL'S CHARITIES BUREAU

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I. Introduction: The Role of the Attorney General in Regulating Charitable Organizations

A. The New York State Attorney General supervises organizations and individuals that administer and/or solicit charitable funds or other charitable assets in New York State. The Attorney General works to protect donors to charity, charities and the beneficiaries of charities. The Attorney General's supervisory authority over charities is rooted in the common law of charitable trusts and corporations, as well as the *parens patriae* power of the State to protect the interest of the public in assets pledged to public purposes. In addition, the Attorney General has broad authority under State statutes to regulate not-for-profit organizations and charitable trusts and to commence law enforcement investigations and legal actions to protect the public interest.

B. The Attorney General is responsible for overseeing the administration of charitable assets in the State of New York, representing the interests of beneficiaries of charitable dispositions and enforcing laws governing the conduct of fiduciaries of charitable entities. (Estates, Powers and Trusts Law ("EPTL") §§ 8-1.1 & 8-1.4; Not-For-Profit Corporation Law ("N-PCL")) Those entities include:

1. Charitable corporations (membership and otherwise)
2. Charitable trusts
3. Charitable estates

C. The Attorney General has authority to oversee the solicitation of charitable assets from New Yorkers, including (i) investigation and prosecution of fraudulent charitable solicitations, (ii) registration of charitable entities which solicit monies in the State of New York and (iii) registration and regulation of professional fund raisers, professional solicitors and fund raising counsel. (Executive Law Article 7-A ("Article 7-A")).

D. The Attorney General has broad authority under the N-PCL to regulate fundamental not-for-profit corporate changes, including:

1. Amendments to certificates of incorporation that change a corporation's purpose (N-PCL § 804)

2. Sale, lease, exchange or other disposition of all or substantially all of a corporation's assets (N-PCL §§ 510, 511)

3. Sales, mortgages or leases of real property by certain religious corporations (Religious Corporation Law § 12)

4. Dissolution (N-PCL Articles 10 & 11)

5. Mergers and consolidations (N-PCL § 907)

E. The Charities Bureau has prepared booklets to assist corporations and their attorneys in such transactions. The booklets, which are available on the Attorney General's website (www.oag.state.ny.us/charities/charities.html), include the following:

1. Procedures for Forming and Changing Not-For-Profit Corporations in New York State;

2. Procedures and Forms for a No Assets Non-Judicial Dissolution Pursuant to Article 10 of the Not-For-Profit Corporation Law;

3. Procedures and Forms for a Voluntary Non-Judicial Dissolution Pursuant to Article 10 of the Not-For-Profit Corporation Law of a Not-For-Profit Corporation With Assets;

4. A Guide to Sales and Other Dispositions of Assets Pursuant to the Not-For-Profit Corporation Law §§ 510-511 and Religious Corporation Law Section § 12; and

5. Quorum Requirements for Religious Corporations in Real Property Transactions.

F. Foreign Trusts and Corporations. Under the EPTL, the Attorney General's registration and oversight extends to charitable trusts created under the laws of other jurisdictions that have assets in New York. The N-PCL applies to foreign charitable corporations that conduct activities in New York. Under Article 13, they should also qualify with the New York Secretary of State in order to do so. Article 7-A applies to the solicitation of charitable contributions from New Yorkers by foreign charities and foreign fund raising professionals.

G. Ordinarily any issues and questions can be resolved through discussions and negotiations between counsel for a not-for-profit corporation, charitable trust or estate with vested or contingent charitable beneficiaries and an attorney in the Charities Bureau or, in counties outside the Albany or New York City, by staff in the Attorney General's regional offices, without the need for the filing of formal objections and the litigation of the dispute. In appropriate cases, the Attorney General has issued non-binding "no action" letters indicating that if an assumed set of facts is the case, the Attorney General would not take an adverse action.

The Attorney General is not authorized to issue formal or informal opinions except to public agencies and officers.

II. Attorney General's Oversight Role in Administration of Charitable Assets

A. The Attorney General has broad statutory authority to prosecute and defend legal actions to protect the interests of the State and the public. Executive Law § 63 *et seq.*

B. The Attorney General has broad statutory authority to “investigate transactions and relationships of trustees for the purpose of determining whether or not property held for charitable purposes has been and is being properly administered.” EPTL § 8-1.4(i).

1. The Attorney General has the power to issue and enforce subpoenas. EPTL § 8-1.4 (j), (k); Executive Law §§ 63(12) & 175.2(h); N-PCL § 112(b)(6).

2. The Attorney General also “may institute appropriate proceedings to secure compliance with . . . section [8-1.4 of the EPTL] and to secure the proper administration of any trust, corporation, or other relationship to which this section applies.” EPTL § 8-1.4(m).

3. The Attorney General may institute a proceeding against a charitable organization that fails to apply “funds solicited from the public in a manner consistent with its charitable purposes or the solicitation for charitable purposes.” Executive Law § 175.2(e).

C. Thus, the Attorney General can initiate court action seeking the removal of trustees, broadly defined, who authorize, or acquiesce in, inappropriate payments or other benefits to fellow trustees. *See* EPTL 8-1.4(m) & (n). Under the N-PCL, the Attorney General may bring an action to remove directors and officers of a not-for-profit corporation for cause. N-PCL § 112(a)(4), 706(d) & 714(c).

D. The Attorney General can also seek to surcharge individual trustees who have arguably squandered or wasted charitable assets, requesting a court to order one or more trustees to pay restitution to the charitable organization and thereby make it whole. Under the N-PCL, the Attorney General may bring an action against directors and officers of a not-for-profit corporation for breach of fiduciary duties, including mismanagement and waste of corporate assets. N-PCL § 720.

E. N-PCL §§ 720(a)(2) & (3) authorize the Attorney General to bring an action to prevent or set aside an unlawful conveyance, assignment or transfer of corporate assets.

F. Fiduciary duties of directors and officers of not-for-profit corporations

The Attorney General is the public officer with primary enforcement authority with respect to the management of charitable organizations and oversees the conduct of the organizations' directors and officers. The Attorney General's legal authority in this area stems directly from the Attorney General's role as the enforcer of the duties of care, loyalty and

obedience. These duties apply whether the particular organization is required to register or is exempt from registration.

1. The duty of care: The common law duty of care requires that the trustees, directors and officers of charitable organizations be attentive to the organization's activities and finances and actively oversee the way in which its assets are managed. This includes attending and participating in meetings, reading and understanding financial documents, ensuring that funds are properly managed, asking questions and exercising sound judgment. New York has codified the standard for the duty of care in N-PCL § 717, which provides that directors and officers of not-for-profit corporations "shall discharge the duties of their respective positions in good faith and with the degree of diligence, care and skill which ordinarily prudent [persons] would exercise under similar circumstances in like positions." *See also* EPTL §§ 11-1.7, 11-2.2 & 11-2.3.

2. The duty of loyalty: The common law duty of loyalty requires trustees, directors and officers to pursue the interests and mission of the charitable organization with undivided allegiance. Private interests must not be placed above the charity's interests. The N-PCL addresses certain aspects of this duty. For example, the N-PCL requires directors and officers to act in "good faith" (N-PCL § 717), contains an absolute prohibition against loans to directors and officers (N-PCL § 716) and contains restrictions on self-dealing transactions (N-PCL §§ 406 & 715), as does EPTL § 8-1.8.

3. The duty of obedience: The common law duty of obedience includes the obligation of directors and officers to act within the organization's purposes and ensure that the corporation's mission is pursued. There is no explicit reference to the duty of obedience in the N-PCL. However, the duty may be inferred by the limitations imposed upon corporate activities as set forth in the purposes clause of the certificate of incorporation (N-PCL §§ 201, 202 & 402(a)(2)) and the directors' and officers' obligations as the corporate managers of the not-for-profit organization (N-PCL § 701 & 713). EPTL § 11-2.3(b)(3)(B) explicitly refers to the needs of a trust's beneficiaries.

4. Significant cases:

a. In February, 1997, the New York Regents removed 18 of the 19 trustees of Adelphi University for neglect of their fiduciary duties when they approved an excessive compensation package for President Peter Diamandopoulos. Committee to Save Adelphi v. Diamandopoulos, decision of the Regents of the State University of New York (February 10, 1997). In a subsequent proceeding brought by the Attorney General against the former trustees, the New York County Supreme Court held that the lawsuit stated claims for relief against defendants, including causes of action against Diamandopoulos for breach of fiduciary duty and claims against the other trustees for reimbursement of the legal fees spent by them on their defense before the Board of Regents. Vacco v. Diamandopoulos, Index No. 401253/97 (Sup. Ct. N.Y. County April 6, 1998) The court also denied the trustees' motion for advance indemnification.

b. Beginning in 1992, the Attorney General began investigating news reports of the misappropriation and mismanagement of charitable funds at the United Way of America (“United Way”). When new management took over at United Way in 1995, the Attorney General and United Way entered into an Assurance of Discontinuance that required certain corporate governance reforms at the agency. Separately, the Attorney General sued two former United Way officers for alleged breach of fiduciary duty, seeking, *inter alia*, recovery of funds misappropriated from United Way. In July 1998, the court held that the Attorney General had standing to sue these officers for losses suffered by the not-for-profit entity as a result of their breaches of fiduciary duty and granted the Attorney General’s motion for partial summary judgment on the issue of liability based on the two officers’ criminal convictions. Vacco v. Aramony, N.Y.L.J., Aug. 7, 1998, p. 21 (Sup. Ct. N.Y. County July 13, 1998).

G. In general, EPTL § 8-1.4 “shall be liberally construed so as to effectuate its general purpose of protecting the public interest in charitable uses, purposes and dispositions.” EPTL § 8-1.4(e) deals specifically with the types of proceedings, such as probate contests, construction proceedings and fiduciary accountings, which are frequently brought in state court (Surrogate’s Court or Supreme Court) involving charitable trusts and estates with charitable beneficiaries, where the Attorney General is a respondent (and a necessary party).

1. Probate contests often involve disputes within a family, or a family member’s challenge to a will, where one or more charities are beneficiaries.

2. The Attorney General’s review of fiduciary accountings in estate proceedings include, in part, scrutiny of executors, trustees, guardians and legal and other professional fees (which would affect the amount received by charitable beneficiaries in the residuary).

3. The Attorney General also seeks, in accounting proceedings involving charitable trusts and estates, to uphold high standards of fiduciary conduct.

a. In its 1993 decision in Estate of Donner, 82 N.Y.2d 574, 606 N.Y.S.2d 137 (1993), a case in which the Attorney General actively participated, the New York State Court of Appeals re-emphasized the obligations of fiduciaries in the State of New York with respect to the management of assets and their dealings with beneficiaries, by upholding a surcharge on the coexecutors for investment losses incurred by the estate and a reduction in the coexecutors’ commission due to the failure of the coexecutors to act prudently in investing the estate’s assets.

b. More recently, in Matter of Janes, 90 N.Y.2d 41, 659 N.Y.S.2d 165 (1997), another case in which the Attorney General was an active participant, the Court of Appeals repeatedly relied on Donner to uphold a finding of liability against the corporate fiduciary of a multi-million dollar estate for failure to invest the assets of the estate prudently. The Court of Appeals also affirmed the Appellate Division, Fourth Department, award of damages of \$4.1 million, using a measure of damages consistent with Donner and its 1977 decision in Matter of Rothko, 43 N.Y.2d 305, 401 N.Y.S.2d 449 (1977). The measure of

damages is the value of the lost capital not lost profits. To calculate damages, determine the difference between the value of the stock on the date it should have been sold and either the proceeds from the sale of the stock if sold or the value of the stock at the time of the accounting if retained.

c. In Community Service Society v. The New York Community Trust, 713 N.Y.S.2d 712 (1st Dep't 2000), the Appellate Division affirmed the New York County Surrogate's decision that the action of New York Community Trust ("NYCT") in 1971 to discontinue charitable trust income payments to the named beneficiary Community Service Society ("CSS") was unauthorized. The Appellate Division held that NYCT's exercise of its variance power should have been limited to situations where "identifiable negative details" are offered to substantiate the "undesirability" of continued payments. The Appellate Division also held that CSS's recovery was barred by a six year statute of limitations since it received notice of the exercise of the variance power in 1971.

In CSS, the Attorney General appeared but took no position at the trial before the Surrogate. On appeal, the Attorney General argued that the NYCT's exercise of the variance power was improper. The Attorney General also argued that when the NYCT exercises its variance power, it should give notice to the Attorney General in addition to the disadvantaged beneficiary. The Appellate Division did not accept this argument, ruling instead that NYCT, having notified the beneficiary, was not obligated also to notify the Attorney General. Presumably, had there been no named beneficiary, the Attorney General would have to have been notified.

H. Restricted assets: The Attorney General's regulatory and enforcement powers include authority to ensure that funds or property donated for specific charitable purposes are indeed used for such purposes. *E.g.*, EPTL §§ 8-1.1 and 8-1.4; N-PCL § 522, N-PCL §§ 717 and 720; Executive Law § 175(2)(e). In general, the instruments establishing charitable organizations and entities are strictly construed according to their terms. As in general contract law, parol evidence is not properly considered in assessing whether, for example, the trustee of a charitable trust has complied with the terms of the trust, so long as the trust instrument is not ambiguous and the trustee has fully complied with its literal terms. Mercury Bay Boating Club v. San Diego Yacht Club, 76 N.Y.2d 256 (1990) (the America's Cup case).

The Attorney General represents the public as the ultimate beneficiaries of charitable dispositions and has the statutory duty to enforce the rights of such beneficiaries by appropriate proceedings in court. EPTL § 8-1.1(f). Additional pertinent statutory provisions include:

1. N-PCL § 513 - Administration of assets received for particular purposes: The governing board of a not-for-profit corporation generally must use assets received for specific purposes for those purposes and associated administrative costs. N-PCL § 513(b).

2. N-PCL § 522 - Release of restrictions on use or investment: Restrictions imposed on a not-for-profit corporation's use of funds may be lifted upon written consent of the donor. N-PCL § 522(a). Alternatively, "[i]f written consent of the donor cannot be obtained by

reason of his [or her] death, disability, unavailability, or impossibility of identification, the governing board may apply in the name of the corporation” to the appropriate state supreme court or surrogate’s court for an court order releasing the restriction. N-PCL § 522(b). The Attorney General must receive notice and have an opportunity to be heard. N-PCL § 522(b). The court may release a restriction, in whole or part, pursuant to this section if it “finds that the restriction is obsolete, inappropriate, or impracticable.” N-PCL § 522(b). The release may not allow funds to be used for other than the existing purposes of the corporation. N-PCL § 522(c). A *quasi cy pres* standard applies to applications to lift restrictions pursuant to this section. N-PCL § 522(d); Alco Gravure, Inc. v. Knapp Foundation, 64 N.Y.2d 458, 462, 490 N.Y.S.2d 116, 479 N.E.2d.752 (1985).

N-PCL § 522 explicitly states that it does not abrogate a court’s equity *cy pres* power. See II.H.5. *infra*.

3. Not-For-Profit Corporation Endowment Funds - A commonly imposed restriction prevents the corporation from spending the principal, thereby creating an endowment fund. Pursuant to section 102(a)(13) of the N-PCL, an endowment is “not wholly expendable by the corporation on a current basis.”

Properly invested, an endowment fund can generate significant appreciation, both realized and unrealized. Pursuant to section 513(c) of the N-PCL, the value of the assets when given, known as the historic dollar value, may not be expended by the corporation. Instead, the assets must be invested, and the income – traditionally, interest, dividends, rents and royalties – is available for expenditure, even if the value of the principal drops below historic dollar value, whether because of specific investment losses or general decline in market values. However, in cases where the endowment fund principal has depreciated below the historic dollar value, the board of directors of the corporation may, if consistent with the gift instrument, prudently determine not to expend this income until the historic dollar value is restored. Similarly, it may be prudent for the board to determine upwardly to adjust the historic dollar value of the endowment fund for inflation to maintain its buying power.

In addition, if the value of the assets has appreciated over the historic dollar value, the net appreciation, realized (with respect to all assets) and unrealized (with respect only to readily marketable assets) may be appropriated for expenditure, unless prohibited by the donor in the applicable gift instrument. Pursuant to section 513(c) of the N-PCL, the board of directors of the corporation may appropriate these amounts if such a decision is prudent under the standard established by N-PCL section 717 (Duty of directors and officers). Thus, officers, directors and managers of New York State not-for-profit corporations should be aware that, even if the applicable gift instrument permits the expenditure of endowment fund appreciation, it cannot be expended unless the governing board appropriates the appreciation prudently.

As to prudence, section 717(a) of the N-PCL requires a governing board to “consider among other relevant considerations the long and short term needs of the corporation in carrying out its purposes, its present and anticipated financial requirements, expected total return on its investments, price level trends, and general economic conditions.” In addition, pursuant to

N-PCL section 513(b), the treasurer is required to make an annual report to the board concerning the administration and use of the assets in each of the endowment funds held for specific purposes and the income from such assets. (see also section 519(a)(2) of the N-PCL) The board should review all relevant information on the endowment funds, including the treasurer's annual reports. The board should also deliberate and vote on whether and to what extent to appropriate endowment appreciation for expenditure. Deliberations and decisions of the governing board should be thoroughly documented in resolutions in the minutes.

General purpose financial statements of not-for-profit corporations, prepared in accordance with Generally Accepted Accounting Principles, account for endowment appreciation as unrestricted net assets (or temporarily restricted net assets if the fund is for specific purposes). Officers, directors and managers should be aware that even though such amounts are recorded as unrestricted (or temporarily restricted), these amounts are only available for expenditure in accordance with the provisions discussed above.

Questions have been asked about the interplay between a spending rate policy and historic dollar value. N-PCL § 513(c) appears to distinguish between appropriation of net appreciation and its expenditure. A board cannot appropriate net appreciation through application of its spending rate policy if the value of an endowment fund is at or below historic dollar value. The Attorney General believes that the corporation has an affirmative duty pursuant to N-PCL § 513 to restore to the endowment fund (i) any appropriation that occurs when the fund is already below historic dollar value and (ii) in the case of an appropriation that causes the fund to decrease below historic dollar value, an amount equal to the difference between the historic dollar value and the post-appropriation value of the fund. This is the case whether the invasion of historic dollar value is caused by application of a spending rate policy or otherwise. Failure to restore may subject directors and officers to liability for breach of their duty of care pursuant to N-PCL § 717. If the board properly appropriates net appreciation, the corporation may expend such appreciation even if at the time of expenditure endowment fund value drops below historic dollar value. However, like appropriation, such expenditure must be prudent under N-PCL § 717 to which N-PCL § 513(c) explicitly refers. A board may prudently determine not to spend previously appropriated net appreciation or to add income or even properly appropriated appreciation from other unrestricted endowment funds that are above historic dollar value until the value of the endowment fund exceeds historic dollar value.

Questions have also been asked as to whether or not endowment funds can be aggregated for purposes of appropriation for expenditure under N-PCL section 513(c). The N-PCL does not appear to authorize such aggregation. Indeed, the statute's reference to an endowment fund in section 513(c) indicates that appreciation available for appropriation is determined on an endowment fund-by-endowment fund basis. This conclusion is also supported by the references in sections 513(b), (c) and (d) to "applicable gift instrument." Generally, a gift instrument applies to only one endowment fund. It is also supported by the N-PCL sections 102(a)(13), (14), (16) and (17)'s definitions of "Endowment fund," "Gift instrument," "Historic dollar value" and "Institutional fund," each of which is phrased in the singular.

Thus, when there is a general decline in market values, as has been experienced recently, application of a total return spending policy, which provides for the annual expenditure of a percentage of the total net assets of a not-for-profit corporation's endowment fund or funds, could well conflict with the obligation to preserve the historic dollar value of each endowment fund. In such circumstances, only prudently appropriated appreciation above the historic dollar value of a particular endowment fund and endowment fund income would legally be available for expenditure.

4. Charitable Trusts and the Power to Adjust. On Sept. 4, 2001, Governor George E. Pataki signed into law Chapter 243 of the Laws of 2001, effective Jan. 1, 2002, which replaced New York's then Principal and Income Act (EPTL § 11-2.1) with EPTL Article 11-A, providing new definitions of income and principal in a trust or estate.

a. The legislation is not retroactive, but on its face applies to all trusts and estates existing as of, or created on or after, January 1, 2002. The law reflects the current opinion that fiduciaries should be authorized to strike a balance between capital growth and the need to provide sufficient income for current income beneficiaries and not necessarily be constrained by the common law or statutory definitions of principal and income.

b. The definition of income was expanded to include an appropriate part of a fund's "total return," made up not only of interest, dividends, rents and royalties but also capital gains on investments of trust or estate principal. The legislation amended the prudent investor standard of fiduciary conduct set forth in EPTL § 11-2.3 by granting fiduciaries the "power to adjust" funds between income and principal (in either direction) during or at the end of each fiscal year. See EPTL § 11-2.3(b)(5)(A).

c. After prudently reviewing past and the longer term expectation performance of the trust's or estate's investments, the trustee may distribute so much of the "total return" to the present income beneficiary as would be "fair and reasonable" to all beneficiaries.

d. Finally, newly added EPTL § 11-2.4 permits a trustee (but not an executor) to make an election, in lieu of determining income in a trust by using the power of adjustment, to have trust income equal a fixed percentage (called a "unitrust") of four percent of the trust assets valued annually for the first three years. Thereafter, a formula applies.

e. The power to adjust appears to apply to charitable trusts, but the legislation minimizes its effect:

(1) the power may not be exercised in a charitable remainder trust to reduce the remainder passing to charity; and

(2) the power cannot be used to change the amount required to be paid a beneficiary of a charitable remainder unitrust or annuity trust (see EPTL § 11-2.3(b)(5)(C)(iii)).

f. Application of the power to adjust to charitable trusts that are deemed private foundations, as defined (by exclusion) by Internal Revenue Code § 509(a), raises additional issues. Private foundations are subject to a number of requirements that are not applicable to either publicly supported charities or supporting organizations under § 509(a), including the requirement imposed by Code § 4942 that private foundations make a minimum annual qualifying distributions of five percent of their net assets. These requirements are also specifically made applicable to New York trusts by EPTL § 8-1.8(a). Failure to satisfy or make up over time the minimum distribution requirements applicable to private foundations subjects the entity to excise taxes.

The new legislation does not permit a trustee to exercise the power if its exercise may impose a tax burden on the trust. Therefore, the power to adjust should not be applied to trusts that are private foundations if a consequence would be a violation of the minimum distribution requirement.

Furthermore, trusts that are private foundations would appear to be ineligible for the optional unitrust provisions of EPTL § 11-2.4, because that section mandates an annual payment equal to four percent of the net fair market value of the trust assets held, which would appear to violate the minimum distribution requirement of Internal Revenue Code § 4942. However, EPTL § 8-1.8(a)(1) might be interpreted as authorizing the payment of only an additional one percent. The issue is not free from doubt, because EPTL § 11-2.4 is optional.

g. In the case of split interest trusts, the power to adjust does not eliminate a trustee's duty of impartiality, i.e., to treat fairly the interests of present and future beneficiaries or remainder or reversionary interests.

h. Chapter 243 of the Laws of 2001 does not apply to endowment funds administered by not-for-profit corporations, including cemetery corporations under N-PCL Article 15, or to corporations organized pursuant to the Religious Corporations Law or Education Law.

5. *Cy pres* (EPTL Article 8): If the gift instrument is a testamentary trust or will, a restriction can only be lifted by the Surrogate's Court pursuant to EPTL Article 8. In such instances, the narrower *cy pres* standard applies. The court may lift part or all of the restriction if the applicant demonstrates that "circumstances have so changed since the execution of [the gift instrument]" that it is "impracticable or impossible" to comply literally with the terms of the charitable disposition, and the modification in the court's judgment will "most effectively accomplish" the gift's original general purposes. EPTL § 8-1.1(c)(1). If, under the doctrine of *cy pres*, a charitable entity seeks deviation from the terms of a charitable gift or bequest (such as in a trust instrument or deed of gift), such relief can be granted only by a New York court in a proceeding initiated on notice to the Attorney General.

a. Long Island College Hospital ("LICH"): In Matter of Donald F. Othmer, 710 N.Y.S.2d 848 (Surr. Ct. Kings County 2000), and Matter of Mildred Topp Othmer, N.Y.L.J., June 8, 2000 at 32 (Surr. Ct. Kings County May 30, 2000), the Court granted *cy pres*

relief to LICH, which permitted LICH to use the restricted principal of endowment fund bequests as collateral to secure almost \$90 million of new financing for necessary capital improvement projects and immediate working capital needs. The LICH decision represents highly significant precedent relevant to not-for-profit corporations, as the first decision to address in detail the obligations of fiduciaries of not-for-profit corporations to safeguard charitable endowment fund assets while addressing an emergency financial situation.

I. The Attorney General has traditionally and historically had standing to enforce the terms of charitable gifts and to assure that restricted gifts are utilized for the purpose intended by the donor. St. Joseph's Hospital v. Bennett, 281 N.Y. 115 (1939)

1. Directors, officers and a certain number of members in a membership organization also have standing to initiate actions on behalf of, or with respect to, the conduct of the charitable organization which they serve (including the authority to seek to enforce the terms of a restricted gift).

2. Whether the donor of a restricted charitable gift has standing, in addition to the Attorney General, to enforce the terms of the gift was recently addressed by the Appellate Division, First Department, which ruled in April of 2001, in Smithers v. St. Luke's Roosevelt Hospital Center, 723 N.Y.S.2d 426 (1st Dep't 2001), that a legal representative of the donor of funds utilized to establish the Smithers Alcoholism Center has common law standing to enforce certain alleged terms with respect to the gift.

III. Registration and Reporting

A. Charities: The Attorney General also operates, through the Charities Bureau, a Registration Section which receives registrations, annual reports and filing fees, pursuant to EPTL § 8-1.4, from charitable organizations which administer assets in the State of New York (subject to certain statutory exceptions described in sections 5.a. & 6. below).

Charitable organizations that solicit contributions from New York State residents must also comply with registration and reporting requirements of Article 7-A of the Executive Law (see paragraph B. below).

1. EPTL § 8-1.4 defines "trustees" (the entities covered by the statute) broadly to include individuals, corporations, estates, trusts and other entities which administer property for charitable purposes in New York State (including foreign charitable corporations or trusts doing business or holding property in the State).

2. EPTL § 8-1.4 requires the registration of charitable entities with the Attorney General and the filing of annual reports, together with the payment of a filing fee.

3. Subsection (d) requires registration within six months after holding of property for charitable purposes (which ordinarily includes filing of certificate of incorporation

and receipt of Internal Revenue Code § 501(c)(3) determination letter from the Internal Revenue Service).

4. Subsections (f) and (g) require filing of annual reports within six months of conclusion of each fiscal year (usually by June 30, where fiscal year is the calendar year).

5. Filing fees which are required for the filing of annual reports (but not with registration) are based on a schedule in subsection (p)

a. Fees range from \$25 to \$1500 per year depending on size of organization, based on assets of organization at close of fiscal year, with exemption from filing reports and paying fees if both income and assets are below \$25,000 per year (in which case a verified statement must be filed confirming entitlement to the exemption under subsection (q)).

b. If income during the year is high, but few or no assets remain at end of year, the minimum filing fee of \$25 must be paid.

c. The largest fee becomes applicable only if the organization's net worth is over \$50 million.

6. Applicability of registration and reporting provisions is limited by subsection (b) to exclude government agencies, religious organizations, educational organizations, parent teachers associations, hospitals, fraternal organizations, patriotic organizations, veterans groups, volunteer firefighters, ambulance workers, social, student or alumni organizations and historical societies, trusts with deferred or contingent charitable interests and cemetery corporations.

a. These are generally groups that are either regulated by other state agencies (such as hospitals and educational institutions), are essentially for the benefit of their own members (fraternal, patriotic, veterans, etc.) or are exempt for a clear public policy reason (such as religious groups).

7. Subsection (l) makes the reports a matter of public record so long as permitted by laws of United States and other government agencies (which exempts donor information based on Internal Revenue Service restrictions concerning 990s).

8. Subsections (r) and (s) were added at the Attorney General's request to encourage compliance with registration and reporting requirements.

a. Subsection (r) makes the charity liable for a fine of \$10 per day, up to a maximum of \$1,000 for each failure to comply with the registration and reporting requirements, but only after service by the Attorney General of a certified letter advising the charity of the failure to comply. After the 30-day period has expired, the fines can be imposed except that, where the Attorney General "finds that the failure to comply ... is due to excusable

ignorance or inadvertence or other reasonable cause, the attorney general shall waive the fine imposed by this paragraph.”

b. Subsection (s) provides that a charity “shall not be qualified to make application for funds or grants or to receive such funds from any department or agency of the state without certifying compliance” with the registration and reporting requirements.

B. Solicitation of Charitable Contributions: Executive Law Article 7-A, New York’s charitable solicitation law, requires that organizations, whether New York or foreign, which solicit charitable contributions, including government grants, in New York, the professional fund raisers and fund raising counsel retained by those charities and the individual solicitors employed by the fund raisers register with, and pay annual filing fees to, the State of New York.

1. The law, which was enacted in 1977, further prohibits charities from retaining unregistered fund raisers and fund raising counsel and similarly bars the fund raisers from employing unregistered solicitors.

2. The 1986 amendments to Article 7-A expanded the definition of fraudulent solicitation to provide that misleading and deceptive practices are prohibited and made it clear that “[t]o establish fraud neither intent to defraud nor injury need to be shown.” A new § 172-d consolidated many of the prohibited activities and added other prohibited activities.

3. Section 172-d provides, in part, that no person shall “[e]ngage in any fraudulent or illegal act, device, scheme, artifice to defraud or for obtaining money or property by means of a false pretense, representation or promise, transaction or enterprise in connection with any solicitation” for charitable purposes. Among the new activities prohibited by the 1986 amendments to the statute were the following: using contributed funds for purposes inconsistent with those for which they were solicited; using coercive tactics when soliciting funds; misleading the public by using a symbol or service mark similar to that of another organization; voting or using personal influence as a director or officer on matters where a conflicting interest exists because the board of a charitable organization consists of a majority of professional fund raisers or their designees; and using the fact of registration with the State of New York to mislead the public that registration constitutes endorsement by the state.

4. A 1989 amendment to Article 7-A added law enforcement support organizations to the definition of charitable organizations governed by the statute. Solicitations purportedly by or on behalf of police or law enforcement support organizations (but actually unconnected to legitimate police officials) have remained a major issue in recent years.

5. A 1992 Appellate Division decision, in an enforcement action brought by the Attorney General, presented a very rare situation where an individual involved in repeated fraudulent solicitations, including in violation of a court order, was preliminarily enjoined from conducting any further charitable solicitations through the corporate defendant or any other entity. People by Abrams v. NYS Federation of Police, 188 A.D.2d 689, 590 N.Y.S.2d 573 (3d Dep’t 1992).

6. The United States Court of Appeals for the Second Circuit ruled in March of 1995 that New York's \$80 annual registration fee on charitable solicitors is consistent with the First Amendment and the Equal Protection Clause of the Fourteenth Amendment. National Awareness Foundation v. Abrams, 50 F.3d 1159 (2d Cir. 1995). The Second Circuit held that the fees were not an unconstitutional prior restraint on free speech and were permissible because they could be considered nominal and were used to defray administrative and enforcement costs of New York's registration system.

7. Also in 1995, the New York State Legislature modified Article 7-A to provide that the administration of Article 7-A be transferred to the Attorney General and, accordingly, that all filings by entities involved in the solicitation of charitable funds in New York be submitted, with the appropriate filing fees, to the New York Attorney General rather than to the Secretary of State. Chapter 83 of the Laws of 1995.

C. 2002 Amendments to Article 7-A and EPTL Section 8-1.4: Article 7-A and EPTL Section 8-1.4 were amended in June of 2002 (effective August 1, 2002). The amendments affect the responsibilities of charities, trusts and estates that conduct activities and/or raise funds in New York and fund raising professionals that act on their behalf.

1. General Provisions

a. Article 7-A and EPTL Section 8-1.4 are now cross-referenced to clarify that entities required to register pursuant to both statutes are only required to register once and file one annual financial report as long as the report fulfills the filing requirements of both statutes.

b. Forms and reports required to be filed with the Attorney General's Charities Bureau must be signed under penalties for perjury. The requirement to submit notarized forms has been eliminated.

2. Article 7-A

a. Registration of Charities

(1) §172.1(d): A charity required to register with the Charities Bureau must, in addition to other documents previously required, submit "the most recent communication from the Internal Revenue Service regarding any audit thereby."

(2) §172.1(g): A charity required to register with the Charities Bureau must, in addition to information previously required, include in its registration statement (Form CHAR410) a statement whether it or any of its present officers, directors, executive personnel or trustees is or has ever been fined or otherwise penalized or enjoined from soliciting contributions or have been found to have engaged in unlawful practices regarding solicitation of contributions or administration of charitable assets and whether its registration or license has been suspended or cancelled by any court or other governmental agency together with the

identity of such courts or governmental agencies and the reasons for such fine, penalty, injunction, suspension or cancellation.

(3) §172.4: Any charity already registered with the Charities Bureau pursuant to Section 8-1.4 of the EPTL is not required to submit a second registration pursuant to the Executive Law but must submit all financial reports required by Article 7-A in addition to the reports required by the EPTL.

(4) §172.5: Registration pursuant to the Article 7-A terminates when it is withdrawn by the registrant, when it is cancelled or if the registrant fails to file its annual financial report by the statutorily prescribed due date.

(5) §172.7: An organization whose registration to solicit contributions in New York has terminated because it has failed to file an annual report must file all delinquent reports, re-register and pay a \$150 re-registration fee.

b. Financial Reporting By Charities

(1) §172-b.1: The threshold for filing an accountant's audit report is raised from gross revenue in excess of \$150,000 to gross revenue in excess of \$250,000.

(2) §172-b.2: The threshold for filing an accountant's review report is raised from gross revenue in excess of \$75,000 and up to \$150,000 to gross revenue of \$100,000 up to \$250,000.

(3) §172-b.2-a: The threshold for filing an unaudited report is raised from gross revenue up to \$75,000 to gross revenue up to \$100,000.

(4) §172-b.3: A registered charitable organization exempt from filing may submit either a notice of annual filing exemption (CHAR006) or withdraw its registration.

(5) §172-b.4: Prior written approval of the Attorney General must be secured prior to filing of a combined annual financial report by a parent organization and its affiliates.

(6) §172-b.8: A financial report submitted to the Attorney General by a charitable organization that is required to register with the Charities Bureau, but has not yet registered, must be accompanied by all required registration information and documents.

c. Prohibited Activities (§172-d)

(1) §172-d.1: This section, which previously applied to registration documents, was expanded to apply to all documents submitted by registrants and

prohibits making any material statement which is untrue and failing to disclose a material fact in such documents.

(2) §172-d.5: A Charity is prohibited from engaging a fund raising professional unless it receives written confirmation of compliance with Article 7-A from such fund raising professional prior to entering into a contract.

(3) §172-d.6: Prohibits any entity from engaging in any fund raising activities unless registered and in compliance with all applicable filing requirements.

(4) §172-d.10: Prohibits the solicitation of contributions by any entity unless it is registered and in compliance with all applicable filing requirements.

(5) §172-d.12: Prohibits any entity from entering into a fund raising contract unless registered and in compliance with all applicable filing and disclosure requirements.

(6) §172-d.19: Prohibits any entity from including in any solicitation a statement that a charity's or professional fund raiser's financial report is on file with the Attorney General unless the charity or the fund raiser is in compliance with all filing requirements.

(7) §172-d.20: Prohibits the use of a New York State return address in any charitable solicitation unless (A) the charitable organization maintains and staffs an office at that address or (B) both the charity's actual address and the fact that the New York address is a "mail drop" is placed in proximity to the New York address.

(8) §172-d.21: Prohibits falsely stating or implying that a charity conducts programs in New York or that its programs benefit New Yorkers.

d. Registration of Professional Fund Raisers

(1) §171-a.4: The definition of "professional fund raiser" is clarified to confirm that individuals and entities that act as professional fund raisers pursuant to a sub-contract must register with the Charities Bureau.

(2) §173.1: Clarifies that professional fund raisers and fund raising counsel must register with the Charities Bureau only if the charities they represent are required to register. Changes the registration period of a professional fund raiser and fund raising counsel from a fixed period (September 1 - August 31) to a period of one year from the date of registration.

(3) §173.2: Requires professional fund raisers, fund raising counsel and commercial co-venturers to make their records available for audit by their client charities.

(4) §173-a.1: Requires professional fund raisers and fund raising counsel to file copies of fund raising contracts within ten days of their execution. Prohibits a professional fund raiser or fund raising counsel from providing services under any contract if, within fifteen days of its filing, the Attorney General has notified the professional fund raiser or fund raising counsel and the charity of any deficiency in the contract or any deficiency in any of their registration or filings.

(5) §173-b.1: Professional solicitors' registration period is one year from date of registration rather than the prior fixed period of September 1 to August 31.

(6) §174-b.1: Clarifies that all solicitations by or on behalf of a registered charity must disclose that a copy of its annual financial report is available from the organization or from the Attorney General and that such disclosure may only be made by organizations that have actually filed an annual report.

3. EPTL Section 8-1.4

a. §8-1.4(a): Clarifies that the definition of the term "trustee" includes executors and all other trustees of charitable assets.

b. §8-1.4(b): Limits the exemption of entities that report to legislatures to those that file financial reports substantially similar to those required by the EPTL and limits exemption of individual officers, directors and trustees to those whose organizations comply with the registration and reporting requirements of the EPTL.

c. § 8-1.4(f)(1): Requires trustees to send annual reports to all current charitable beneficiaries and to provide the Attorney General and such beneficiaries with notice of the termination of any interest that results in the requirement that trust assets and/or income be applied to charitable purposes.

D. 2003 Regulations Pursuant to Article 7-A and EPTL Section 8-1.4: On April 11, 2003, Attorney General Eliot Spitzer adopted new regulations pursuant to Article 7-A and EPTL Section 8-1.4(h). The regulations become effective on July 1, 2003. They consist of new Parts 90 through 105 of 13 NYCRR. The prior regulations, Parts 100 through 115 of 13 NYCRR, have been repealed.

1. The regulations clarify the registration and annual filing requirements applicable to trustees of charitable assets pursuant to EPTL Section 8-1.4 and charitable organizations and fund raising professionals pursuant to Article 7-A, simplify the procedures for registration by trustees and charitable organizations subject to registration pursuant to both statutes and implement the transfer to the Attorney General of the responsibility of the administration and enforcement of Article 7-A, which until 1995 was the responsibility of the Secretary of State's Office of Charities Registration. The regulations can be found in the New York Code of Rules and Regulations or on the Attorney General's website: www.oag.state.ny.us/charities/charities.html.

2. Charities - Registration and Financial Filing

a. The regulations define the organizations that are subject to registration (Part 90) and contain separate parts applicable to entities required to register pursuant to EPTL Section 8-1.4 (Part 91), entities required to register pursuant to Article 7-A (Part 92) and entities required to register pursuant both statutes (Part 93).

b. Parts 91, 92 and 93 list all of the forms, information and documents required to be submitted by each category of registrant and the signatures required on the forms.

c. Each part also provides that any entity already registered pursuant to one of the statutes is not required to register again to fulfill the requirements of the other, sets forth the fees required to accompany annual reports and describes the procedure for requesting an exemption from filing an annual financial report.

d. Effective August 1, 2002, the Executive Law § 172-b.4(a) was amended to require written authorization from the Attorney General prior to submitting a combined financial report. Section 92.3(c) of the regulations sets forth the information that must be provided to the Attorney General in connection with a request for such authorization and prescribes the contents of a combined report.

e. Sections 92.4 and 93.4 of the regulations incorporate Executive Law § 172.7 which was amended in 2002 to provide that a charitable organization's registration to solicit contributions from New Yorkers ceases upon its failure to file timely an annual report required by that statute.

f. The required content of annual financial reports of registrants is described in Part 94. Part 94.1 includes definitions of accounting terms.

g. Section 94.2(b) describes in detail the contents of the schedules to be filed, as part of the their annual financial report, by charities that engage the services of professional fund raisers, fund raising counsel and/or commercial co-venturers. Information not previously required to be included such schedules includes (1) whether or not the contract was reviewed and approved by the charity's governing body, (2) how many bids, if any, were reviewed by the charity's governing body prior to engaging a professional fund raiser and (3) whether the contract provides for solicitations of new contributors or those who have previously contributed to the charity.

3. Registration and Reporting by Fund Raising Professionals: Part 95 sets forth the registration and reporting responsibilities (section 95.2) and fees and bonding requirements (section 95.3) of professional fund raisers, fund raising counsel and professional solicitors. Section 95.4 sets forth the required content of fund raising contracts (section 95.4(a)) and the contract approval and cancellation procedures. Section 95.5 details the required content of interim and closing statements of professional fund raisers.

4. Extensions of Time to File: Part 96 codifies the Attorney General's procedures for requesting extensions of time to file reports of charitable trustees and organizations. Section 96.1 describes the procedure for requesting an initial extension of time to file an annual financial report and section 96.2 outlines the procedure for requesting further extensions. Section 96.3 sets forth the procedure for securing an acknowledgment of a request for extension of time to file. Procedures, implemented by the Charities Bureau in 2002, for submitting an e-mail request for an extension of time to file are also described in Part 96. Section 96.4 codifies the Bureau's policy of denying extension requests for registrants who are delinquent in filing an annual report for any prior reporting period.

5. Availability of Forms and Instructions: Part 97 provides the mail and email addresses for requesting forms and instructions of the Attorney General's Charities Bureau.

6. Changes in Filed Documents: Part 98 requires that changes in filed documents be provided to the Attorney General within thirty days, that any such document that was initially required to be signed under penalty of perjury must be also be signed under penalty of perjury and that any document that is not so signed shall be incomplete and subject the filer to sanctions.

7. Identification of Filings: Part 99 requires registrants to place their registration number on all instruments, reports, checks, annual financial reports and other documents, including correspondence, filed with the Charities Bureau.

8. Filed Documents are Public Records: Part 100 provides that all filed documents, unless specifically exempt from disclosure, such as lists of contributors to public charities, are public records (section 100.1) and describes the procedure for inspection of such documents (section 100.2).

9. Place of Registration and Filing

a. Part 101 provides that charitable entities required to register pursuant to Article 7-A and/or EPTL Section 8-1.4 must register with the New York City office of the Charities Bureau (part 101.1):

Attorney General
Charities Bureau - Registration Section
120 Broadway
New York, New York 10271

b. Professional fund raisers, fund raising counsel and professional solicitors must register with the Charities Bureau's Albany office (part 101.2):

Attorney General
Charities Bureau
The Capitol
Albany, New York 12224

10. Exemption From Registration: Part 102 requires that entities claiming to be exempt from registration must, within fifteen days of the Attorney General's request that they register, submit documentation of the basis for such claim.

11. Administrative Hearings: Part 103 contains a detailed description of the procedures applicable to administrative proceedings by the Attorney pursuant to section 177 of Article 7-A. Prior to adoption of the regulations, there were no regulations specifically applicable to such proceedings. Part 104 also provides that the regulations do not preclude the Attorney General from initiating any action or proceeding authorized by law for failure to register and/or file financial reports pursuant to, and/or comply with, any provision of Article 8 of the EPTL, Article 7-A of the Executive Law, any other law or the common law.

12. Criminal Enforcement

a. Part 105 provides that (1) the regulations do not preclude the Attorney General from commencing any otherwise authorized criminal proceedings (section 105(a)), (2) any person who swears falsely to filed document may be guilty of a crime under the New York Penal Code(section 105(b)) and (3) all unclassified misdemeanors in Article 7-A are Class A misdemeanors (section 105(c)).

b. The misdemeanors defined in Article 7-A are (1) the failure of professional fund raisers and fund raising counsel to register with and pay a registration fee to the Attorney General, the failure of a professional fund raiser to post a bond with the Attorney General and the failure of professional fund raisers, fund raising counsel and commercial co-venturers to maintain books and records (section 173), (2) the failure of professional fund raisers, fund raising counsel and commercial co-venturers to have written contracts with their client charities and the failure of professional fund raisers to file interim and closing statements (section 173-a), (3) the failure of a professional solicitor to register or pay a registration fee (section 173-b) and (4) the unauthorized use of names when soliciting or collecting contributions (section 174-d).

E. United States Supreme Court Decisions Affecting Charitable Fund Raising.

1. As a result of a series of United States Supreme Court decisions in the 1980s, charitable solicitations are protected First Amendment activity and are not merely commercial speech. (The leading case is Riley v. National Federation of the Blind, 487 U.S. 781 (1988).) As a result, states and localities cannot currently require the charity, or its paid fund

raiser, to make certain point-of-solicitation disclosures, such as the percentage of solicited funds which are being utilized for administrative or fund raising expenses.

2. On May 5, 2003, the United States Supreme Court ruled in Madigan v. Telemarketing Associates, __ U.S. __, 2003 U.S. LEXIS 3430 (2003) that states may maintain fraud actions when fund raisers make false or misleading representations designed to deceive donors about how their donations will be used. In a unanimous opinion by Justice Ruth Bader Ginsburg, the Court held that the First Amendment protects the right to engage in charitable solicitation, but does not shield fraud.

F. Charitable Fiduciaries' Responsibilities for Legally Required Reports

1. The disclosure to the Attorney General, primarily through United States Treasury Form 990 required under EPTL § 8-1.4(f)(2) and/or Executive Law §§ 172(9) and 172-b(7) and the Attorney General's regulations thereunder, 13 NYCRR parts 100 & 110-115 (1997), is the principal means by which the Attorney General may learn of the existence of self-dealing, excess compensation and other interested parties or prohibited transactions between charitable trusts and not-for-profit corporations and their trustees, officers, directors or other managers or third parties. As noted in the former Practice Commentaries to the EPTL, the Legislature enacted the disclosure in recognition that responsibilities of the Attorney General with respect to charitable assets "could not be adequately enforced without the receipt or regular reports from the administrators of charitable assets." McKinney's Cons. Laws of N.Y., Book 17B, Estates, Powers and Trusts Law, § 8-1.4, Practice Commentary 73 (1991).

2. Under N-PCL § 520, regardless of whether a director has any actual involvement with the preparation of the corporation's reports filed with the Attorney General, he or she cannot claim ignorance of a corporation's failure to file the required reports. Such failure "constitute[s] a breach of the directors' duty to the corporation." N-PCL § 520 provides:

Each domestic corporation, and each foreign corporation authorized to conduct activities in this state, shall from time to time file such reports on its activities as may be required by the laws of this state. All registration and reporting requirements pursuant to EPTL 8-1.4, or related successor provisions, are, without limitation on the foregoing, expressly included as reports required by the laws of this state to be filed within the meaning of this section. Willful failure of a corporation to file a report as required by law shall constitute a breach of the directors' duty to the corporation and shall subject the corporation, at the suit of the attorney-general, to an action or special proceeding for dissolution under article 11 (Judicial dissolution) in the case of a domestic corporation, or under § 1303 (Violations) in the case of a foreign corporation. (emphasis added).

See also N-PCL § 521.

3. Similarly, the Internal Revenue Code gives the Treasury Secretary the authority to impose fines on directors and officers who are responsible for a charitable

organization's failure to file or completely file Form 990. 26 U.S.C. § 6652(c)(1)(B); see 26 C.F.R. 301.6652-2(b).

4. The American Institute of Certified Public Accountants Financial Accounting Standards Board Statement No. 57, *Related Party Disclosures*, establishes the accounting standards and disclosure requirements for financial statements presented in conformance with Generally Accepted Accounting Procedures (GAAP). Statement on Auditing Standards ("SAS") No. 45 sets forth the auditing standards and procedures an auditor should follow to determine related party transactions:

a. Evaluate the company's procedures for identifying and properly accounting for related party transactions (.07a).

b. Request from appropriate management personnel the names of all related parties and inquire whether there were any transactions with these parties during the period (.07b).

c. Review the minutes of meetings of the board of directors and executive or operating committees for information about material transactions with related parties (.08b).

5. Accordingly, the Attorney General relies on the Forms 990 and other filed financial reports for identification of, *inter alia*, self-dealing transactions between a charitable trust and its trustees or a not-for-profit corporation and its officers or directors or other managers. The information regarding interested party transactions is peculiarly within the possession of the trustee, director or officer involved. Except where the interest of a fiduciary is manifest (e.g., the board is aware of a director's professional association with a company with which the corporation is dealing), the trust or corporation will not learn of the interest unless the fiduciary discloses it as the common law and N-PCL §715 requires. If that disclosure is made to them, the charities' fiduciaries are responsible for the disclosure to the I.R.S. and the Attorney General.

6. Both the Internal Revenue Service and the Attorney General take the position that materially incomplete or incorrect filings do not start any statute of limitations running.

IV. The Attorney General's Authority under the N-PCL to Regulate Fundamental Not-For-Profit Corporate Changes

A. The N-PCL requires a not-for-profit corporation to obtain State Supreme Court approval, upon notice to the Attorney General, before it may (1) amend its purposes or powers (N-PCL Article 8), (2) sell, transfer or otherwise dispose of all or substantially all of its assets (N-PCL Article 5), (3) merge or consolidate (N-PCL Article 9) or (4) dissolve (N-PCL Article 10). The Attorney General is a necessary party to the court proceeding and may file objections to the proposed terms. However, the court is the ultimate decision-maker. *See*

Historic District Council v. Spitzer, Index No. 116464/00 (Sup. Ct. New York County October 3, 2000) (in dissolving a temporary restraining order preventing New York University School of Law from proceeding with construction of a new building on the site where Edgar Allen Poe lived when he wrote “The Raven,” the Court held that, although the Attorney General had to review Judson Memorial Church’s decision to sell its adjacent property to NYU, such review did not constitute “state action” and, therefore, historic preservation review by a state official was not triggered).

B. It is a common and better practice for organizations to provide the Attorney General with the terms and conditions of their proposed transaction in advance of the actual court filing. Such a procedure enables the Attorney General to review the transaction and raise concerns before the court application is filed. When the court application is filed, the Attorney General may either give a “no objection” endorsement or file objections. The Attorney General ensures that charitable assets are being protected and preserved for appropriate charitable purposes. In reviewing proposed transactions, the Attorney General and the court are guided by the *quasi cy pres* doctrine. Under the concept of *quasi cy pres*, when a not-for-profit organization undergoes a fundamental corporate change, its charitable assets, or the value of such assets, may only be transferred to a not-for-profit organization or organizations “engaged in activities substantially similar” to those of the not-for-profit organization that is transferring the assets.

C. Amendments to certificates of incorporation changing purpose or powers of a charitable organization (N-PCL § 804)

1. Alco Gravure v. Knapp Foundation, 64 N.Y.2d 458 (1985), held that an amendment to the certificate of incorporation could not short-circuit the *quasi cy pres* doctrine.

a. This case emphasizes the importance of careful scrutiny of proposed amendments by the Attorney General in order to protect the interests of charitable beneficiaries

2. The Attorney General’s review is important to:

a. ensure that the proposed changes in purposes or powers are consistent with the charitable nature of the organization

b. ensure that where the charity’s new purposes do not overlap with its original purposes, the charitable assets obtained by a charity for its original corporate purpose continue to be used for that restricted purpose unless the restriction is judicially altered, pursuant to the doctrine of *cy pres*. See Alco Gravure v. Knapp Foundation, 64 N.Y.2d 458 (1985).

3. Recent cases:

a. The Nathan Littauer Hospital Association (“Littauer”) case (Nathan Littauer Hosp. Ass’n v. Spitzer, 287 A.D.2d 202, 734 N.Y.S.2d 671 (3d Dep’t 2001)),

leave to appeal denied, 2002 N.Y. LEXIS 940 (N.Y. April 30, 2002): The Appellate Division, Third Department, affirmed a decision of the Fulton County Supreme Court holding that court approval was not required for the proposed affiliation of Littauer and St. Mary's Hospital at Amsterdam, both of which are New York not-for-profit corporations. The Court determined that the act of delineating powers already validly possessed by a particular corporation, including the power to approve the sale or other disposition of assets under certain specified circumstances, does not constitute an addition of corporate powers, thereby triggering the review and approval procedures mandated by N-PCL § 804(a)(ii), even if the right to exercise those powers is reserved to another corporation, thereby shifting control to such corporation. The Attorney General's motion for leave to appeal was denied by the Court of Appeals. But see Herbert H. Lehman College Foundation, Inc. v. Fernandez, 292 A.D.2d 227, 739 N.Y.S.2d 375 (1st Dep't 2002) (where control by a college of a foundation created to support the college was accomplished through certificate of incorporation provisions ensuring that college representatives would constitute a majority of the board of directors, the amendment of such certificate provisions, which permitted a change in control, constituted an amendment of the corporation's purposes requiring court approval, on notice to the Attorney General, pursuant to N-PCL § 804(a)(ii)).

D. Sale or transfer of all or substantially all the assets (N-PCL §§ 510, 511)

1. In order to authorize the transaction, the court must be satisfied "that the consideration and the terms of the transaction are fair and reasonable to the corporation and that the purposes of the corporation or the interests of its members will be promoted." N-PCL § 511(d).

2. The Attorney General's review is designed to ensure compliance with statutory requirements, including the following:

a. a statement that the proposed transaction has been properly approved by the directors and/or members of the charity [or religious corporation] making the sale;

b. evidence that the charity [or religious corporation] will receive fair market value in the case of sale (which must be demonstrated by an independent, arms-length appraisal);

c. a demonstration that the proposed transaction promotes the best interests of the corporation;

d. in the case of transfers to another religious or nonprofit corporation without consideration, the only issue presented is whether the transfer is in the interest of the transferring organization (since transfers can be made from one charity to another without consideration); and

e. notice to creditors in case of insolvency.

3. Recent cases:

a. Rose Ocko Foundation case: In Rose Ocko Foundation, Inc. v. Lebovits, 259 A.D.2d 685, 686 N.Y.S.2d 861 (2d Dep't 1999), the Second Department affirmed the decision of the Rockland County Supreme Court voiding a sale by the Rose Ocko Foundation of the sale of real property it had been bequeathed to build a home for aged on the ground that the property sold constituted "all or substantially all" of the corporation's assets, but that the required court approval under N-PCL §§ 510 & 511 had not been obtained. The Appellate Division declined to adopt a quantitative or percentage approach urged by the buyers, finding that the property was all or substantially all of the corporation's assets on the basis of such qualitative factors as the fact that the property was the corporation's largest, most significant and most valuable asset and the sale of the property for inadequate consideration severely hampered the foundation's ability to carry out its charitable mission. Having found that the sale was subject to N-PCL §§ 510 & 511, the Appellate Division upheld the trial court's finding that the criteria for court approval under the statute (namely, that the corporation must receive fair and reasonable consideration and that the transaction must promote the corporation's purposes) had not been met, and, as a result, the sale was void.

b. The Manhattan Eye, Ear & Throat Hospital ("MEETH") case (Manhattan Eye, Ear & Throat Hosp. v. Spitzer, 715 N.Y.S.2d 575 (Sup. Ct. New York County December 3, 1999): The New York County Supreme Court denied MEETH's petition to sell all or substantially all of its assets pursuant to N-PCL §§ 510 & 511. The Court determined that MEETH would not receive fair and reasonable consideration from the transaction and that the transaction would not promote MEETH's charitable corporate purposes. The MEETH decision denying the petition is of great significance to the nonprofit community because it reminds directors of their duty of obedience to promote the principal purposes of the nonprofit organization and provides factors for a court (and nonprofit boards) to consider in a sale under N-PCL §§ 510 & 511 to determine whether the consideration and the terms and conditions of the transaction are fair and reasonable and that the purposes of the corporation will be promoted.

c. The Littauer case (see IV.C.3.a. above): The Appellate Division, Third Department, affirmed a decision of the Fulton County Supreme Court holding that court approval was not required for the proposed affiliation of Littauer and St. Mary's Hospital at Amsterdam, both of which are New York not-for-profit corporations. The Court determined that a change in membership resulting in a change of control of Littauer did not constitute an "other disposition of all, or substantially all, the assets" of Littauer requiring court approval pursuant to N-PCL §§ 510 & 511. The Attorney General's motion for leave to appeal was denied by the Court of Appeals. The Attorney General does not necessarily accept the Third Department's decision as binding, except in that Department.

E. Non-judicial dissolution (N-PCL Article 10) and judicial dissolution (N-PCL Article 11) of a charitable organization

1. There are two categories of Article 10 non-judicial dissolutions: no-asset dissolutions and asset dissolutions. If there are no assets to be distributed at the time of dissolution, then the plan of dissolution shall include a statement to that effect. N-PCL § 1001(b). The corporation, *inter alia*, files a plan of dissolution with the Attorney General and seeks court approval (upon notice to the Attorney General) of a petition to file a certificate of dissolution with the Secretary of State. If there are assets to be distributed, then, *inter alia*, the corporation seeks court approval (upon notice to the Attorney General) of the plan of dissolution and distribution of assets. After the assets are distributed and the organization files a zero balance financial report with the Attorney General, the organization seeks court approval (upon notice to the Attorney General) of a petition to file the certificate of dissolution with the Secretary of State.

a. Ensure compliance with procedural requirements (e.g. approval of the dissolution by the board of directors or membership of the organization)

b. Review of financial reports of organization to assure that there has been no improper dissipation of assets prior to dissolution

c. Require registered organizations to file delinquent financial reports and pay the filing fees

d. Require unregistered organizations to register and file reports for a certain number of years (e.g., up to 6 years)

e. Greater level of scrutiny required if organization has assets

f. Plan required for organization with assets to demonstrate transfer or disposition of assets to an organization with substantially similar purposes, pursuant to the doctrine of *cy pres* (standards set forth in 1986 New York Court of Appeals decision in In re Multiple Sclerosis Service Organization of New York, 68 N.Y.2d 861 (1986), granting more discretion to board of charitable corporation than to trustees of a charitable trust to make decision on disposition of assets).

2. In addition, a corporation may be involuntarily dissolved by judicial order. The Attorney General may initiate an action or special proceeding to dissolve a not-for-profit corporation for cause. N-PCL § 112(a)(1), (2), (5) and (7); § 520; § 1101 and § 1102. Under certain circumstances, the directors or members of a not-for-profit corporation may file a petition for judicial dissolution of the corporation pursuant to Article 11 of the N-PCL. The Attorney General is a necessary party to such a proceeding. N-PCL § 1102.

F. Mergers and consolidations (N-PCL § 907): In order to approve the transaction, the court must be satisfied that the statutory requirements have been met and “that the interests of the constituent corporations and the public interest will not be adversely affected by the merger or consolidation.” N-PCL § 907(e). Among the evidence to be submitted to the court is

“the objects and purposes of each such corporation to be promoted by the consolidation.” N-PCL § 907(a)(3).

1. In Matter of Kaiser Foundation Health Plan of New York and Community Health Plan, the Attorney General thwarted Kaiser’s attempt to avoid application of N-PCL §§ 510 - 511 and 907. No. 2068-99 (Sup. Ct. Albany County May 12, 1999). After being served with statutorily-required notice of a merger petition by the above health care facilities, the Attorney General filed objections, asserting, among other things, that (a) Kaiser had previously acquired control over CHP’s operations without court approval through an affiliation agreement and (b) Kaiser intended, after the merger, to sell CHP, but not through a transaction for which it would seek court approval. Relying on N-PCL § 907(e)’s mandate that “the public interest will not be adversely affected,” the court conditionally approved the Kaiser-CHP merger, subject to the condition that any “future non-merger transfers of operational and managerial control of CHP” be subject to the requirement of court approval of mergers under N-PCL § 907(e).

V. Sales, transfers, mortgages and leases of real property by certain religious corporations (Religious Corporation Law § 12)

A. The N-PCL §§ 510 & 511 issues are applicable here, as explained above.

B. In one case, a religious organization which contracted to sell its building, where various programs were carried on (such as a senior citizen center), successfully applied to have the sale disapproved (rather than approved) by the Court, because it could not find a substitute building and had not protected itself from this risk in the contract. The Appellate Division, Second Department agreed that approval of the contract of sale would be contrary to the charitable interest and purpose of the organization and affirmed a lower court order disallowing the sale. Agudist Council v. Imperial Sales, 158 A.D.2d 683, 551 N.Y.S.2d 955 (2d Dep’t 1990). *See also* Church Of G-d v. Fourth Church, 54 N.Y.2d 742, 442 N.Y.S.2d 986 (1981).

VI. Additional Information

For additional information, please consult the Charities Bureau website (www.oag.state.ny.us/charities/charities.html) or contact the Charities Bureau at the following addresses and numbers:

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