

A Guide For New York Not-for-profit Corporations Considering Expenditure of Endowment or Other Restricted Funds



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A GUIDE FOR NEW YORK NOT-FOR-PROFIT CORPORATIONS CONSIDERING EXPENDITURE OF ENDOWMENT OR OTHER RESTRICTED FUNDS

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Introduction

New York State Attorney General Andrew M. Cuomo offers this guide to New York not-for-profit corporations considering an expenditure of endowment funds or other restricted funds.

In the current financial climate, some charities with endowment funds – funds with restrictions on the amount of the fund that may be spent – or funds restricted to a particular use may be giving thought to the possibility of using these funds to meet their financial obligations. This guide provides basic information for such charities and their legal counsel, with emphasis on expenditures that require court approval on notice to the Attorney General.¹

This guide contains general information and is not a substitute for legal advice from an attorney.

What Is An Endowment Fund?

An endowment fund is a gift to charity made by a donor who specifies that the fund cannot be spent in its entirety.² Endowments typically permit the expenditure of income but not principal, or set limits on the amount of the fund that can be spent in any year. Additionally, if an endowment fund has increased in value, the law permits the expenditure of some appreciation over initial value under certain conditions.³ Spending more of an endowment fund than is permitted by the donor or by law is often referred to as “invading” the endowment.

An endowment may be created by a contract between a donor and a charity, or by the donor’s will or trust. Charities are urged to seek the advice of counsel as to whether a particular gift establishes an endowment fund.

What is the Attorney General’s Role?

The Attorney General is designated by statute as the protector of the public interest in charitable gifts, including gifts in endowment form.⁴ The Attorney General is a necessary party to

court proceedings involving gifts to charity, including proceedings in which a charity seeks court permission to invade an endowment or to be relieved of a donor-imposed restriction on the use of a charitable gift.⁵ Such proceedings are discussed in more detail below.

When Is Court Approval Required to Invade an Endowment?

Not all endowment fund invasions require court approval. For example, if the donor of an institutional endowment fund is living, the charity's board may release the spending restriction with the donor's written consent.⁶ If the spending restriction was imposed solely by the charity's board of directors, and not by the donor of the fund – a so-called “board-designated endowment” – the restriction may be removed or modified by the board of directors. If there is any question about the need for court approval with respect to a particular fund, charities and their counsel are urged to discuss the matter with a representative of the Attorney General's Charities Bureau before invading the fund.

In many cases, however, it will be necessary to obtain court approval, on notice to the Attorney General, before invading an endowment fund. The legal doctrine governing such proceedings is called “*cy pres*,” meaning that the court acts to prevent the failure of a charitable gift while at the same time staying as close as possible to the donor's original intent.⁷ *Cy pres* relief must be obtained where the restriction on spending was imposed by the donor and the donor is no longer available to consent to a change in the restriction – for example, if the donor is deceased, or if the endowment fund was created by the donor's will or by a trust that does not permit amendment by the donor.⁸ The court's *cy pres* approval must also be obtained before a charity may spend below an endowment fund's “historic dollar value,”⁹ that is, the original value of an endowment fund at the time of receipt.¹⁰

The *Cy Pres* Standard

Cy pres proceedings in New York are governed by Estates, Powers and Trusts Law § 8-1.1(c). Under that statute, if the court finds that circumstances have changed since the making of a charitable gift so as “to render impracticable or impossible a literal compliance with the terms” of the gift, the court may remove or modify a restriction.¹¹ Before granting *cy pres* relief, the court must find that the donor had “general charitable intent,” that is, that the donor did not intend the gift to fail or the funds to be redirected if the donor's restrictions cannot be honored.¹² The donor, if living, must consent to the request for *cy pres* relief.¹³

In cases of extreme financial hardship, the court may grant *cy pres* relief permitting a charity to invade an endowment fund in order to meet the charity's financial obligations.¹⁴ Note that the use of endowment funds as collateral for a loan is an invasion that requires court approval.¹⁵ The *cy pres* standard in these cases is a stringent one. Generally speaking, the charity must satisfy the Attorney General, and ultimately the court, that it will be impossible or impracticable for the organization to continue to carry out its charitable mission without invading the endowment.¹⁶

Attorney General Review

The Attorney General, as the protector of the public interest in charitable gifts, is a necessary party to all *cy pres* proceedings.¹⁷ Such proceedings are commenced by filing a petition with the court. As noted below, a draft of the petition should be submitted to the Attorney General's Charities Bureau for review before it is filed with the court (see Procedure for Requesting Attorney General Review, below).

In deciding whether to endorse a request for *cy pres* relief permitting invasion of an endowment fund, the Attorney General's Charities Bureau and the court consider a variety of factors, including (1) the severity of the charity's financial hardship; (2) whether the amount of the requested invasion is proportional to the financial need; (3) the charity's proposed use of the endowment funds; (4) the likelihood that an invasion of endowment will improve the charity's financial prospects in the near future; and (5) the charity's efforts to achieve financial recovery by other means, such as cost reductions and fund-raising. The nature and scope of the Charities Bureau's review depends on the facts of each individual case.

The showing of financial hardship in the proposed petition should be based on detailed financial information, including financial reports (audited, where available), budgets and other records showing the charity's current and projected financial condition. The charity should also be prepared to show that it has made good faith efforts to find alternatives, such as expense reductions, fund-raising efforts, sale of non-essential assets, and reductions in non-essential staff, before seeking to invade the endowment. The charity should be able to explain why these alternative measures are insufficient.

The request for permission to spend an endowment fund should be framed as narrowly as possible, adhering as closely as possible to the donor's original terms. For example, instead of requesting to spend endowment funds, the petition may seek the court's permission to borrow from the endowment fund, with an agreement to repay the endowment fund by a specified future date. Alternatively or additionally, instead of seeking to invade or borrow from the entire fund, the petition may seek permission to spend only a portion of the fund. The Attorney General is more likely to support – and the court is more likely to approve – a request that preserves the original terms of the gift to the maximum extent possible.

Additionally, the petition should describe in detail the proposed use of the funds. Funds released by *cy pres* should not be used for discretionary spending but for purposes that will directly contribute to the continued viability of the charity and its programs.

Funds With Restrictions on Use

In some cases, a donor may have restricted the charitable purposes for which a fund may be used. Such restrictions on use may be included in a written contract between the donor and the charity, or in the donor's will or trust agreement. Restrictions on use are distinct from spending restrictions, and may apply to both endowments and non-endowment gifts. Funds restricted as to

use also include funds that the charity solicited for a particular purpose – for example, a capital campaign or a scholarship fund – with the express or implied representation that any funds received would be used only for the stated purpose. Any change to such restrictions on use also requires *cy pres* relief from a court pursuant to Estates, Powers and Trusts Law § 8-1.1 (c).

An alternative to a *cy pres* proceeding exists if the fund is an “institutional fund,” a fund for the benefit of a not-for-profit corporation that is usually held by the corporation itself.¹⁸ If the donor is available, a restriction on the use of such a fund may be released with the donor’s written consent pursuant to Not-for-Profit Corporation Law § 522 (a).¹⁹ If the donor is deceased or otherwise not available to give consent, a restriction on the use of an institutional fund may be released by the court in a proceeding pursuant to Not-for-Profit Corporation Law § 522 (b).²⁰ The Attorney General is a necessary party to the proceeding.

The Standard Under Not-for-Profit Corporation Law § 522 (b)

The wording of the legal standard for release of a restriction under Not-for-Profit Corporation Law § 522 (b) is similar but not identical to the *cy pres* standard discussed above. Under Section 522 (b), the court may release a restriction in whole or in part if it finds that the restriction is “obsolete, inappropriate, or impracticable.”²¹

Not-for-Profit Corporation Law Section 522 (b) provides that “a release under this paragraph (b) may not change an endowment fund to a fund that is not an endowment fund.”²² The release of an endowment restriction requires *cy pres* relief, unless the donor is available and consents in writing pursuant to Not-for-Profit Corporation Law § 522 (a).²³

Procedure for Requesting Attorney General Review

Charities and their counsel are urged to submit proposed petitions for *cy pres* relief or relief under Not-for-Profit Corporation Law § 522 (b), including copies of all applicable gift documents, to the Attorney General’s Charities Bureau for review before filing with the court. Advance review by the Charities Bureau can help to identify and resolve potential issues, thus simplifying the proceeding and saving time. Petitions should be submitted to the Charities Bureau at the earliest possible time to allow sufficient time for review. Please confirm that the Charities Bureau’s review has been completed before commencing a proceeding in court.

Conclusion

For further information, please contact the Attorney General’s Charities Bureau and the address shown above.

This and other Charities Bureau booklets, forms and instructions are available on the Attorney General’s website at http://www.oag.state.ny.us/bureaus/charities/guides_advice.html.

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Notes

1. In 2009, the Uniform Prudent Management of Institutional Funds (UPMIFA) was introduced in the New York State Assembly (A.7907) and is pending. Generally speaking, UPMIFA would permit a not-for-profit corporation to spend its endowment funds if the board of directors determined that such spending was prudent after considering several enumerated factors. The spending of endowment funds would be permitted without court approval in some cases in which court approval is required under current law. If UPMIFA is enacted in New York, some of the guidance in this booklet will no longer be applicable and this Office will issue amended guidance at that time.
2. New York's Not-for-Profit Corporation Law ("N-PCL") defines an endowment fund as an institutional fund held by or for a not-for-profit corporation that is "not wholly expendable by the corporation on a current basis under the specific terms of all applicable gift instruments." N-PCL § 102 (a) (13). *See also* N-PCL § 102 (a) (17) (defining "institutional fund").
3. See authorities cited in Note 10, below.
4. EPTL §§ 8-1.1(f) ("The attorney general shall represent the beneficiaries of such dispositions for religious, charitable, educational or benevolent purposes and it shall be his duty to enforce the rights of such beneficiaries by appropriate proceedings in the courts"). *See also id.* § 8-1.4 (e) (1) (C); N-PCL § 522(b).
5. EPTL §§ 8-1.1(c); N-PCL § 522(b).
6. N-PCL § 522 (a). See Note 23, below, for the text of this provision.
7. *See, e.g., Matter of Multiple Sclerosis Service Organization of New York, Inc. (New York City Ch. of Nat'l Multiple Sclerosis Soc'y)*, 68 N.Y.2d 32, 41, 505 N.Y.S.2d 841, 845-46 (1986):

The common-law cy pres doctrine, or "ancient doctrine of approximation"
. . . embodies the English concept that when a donor parts with his property for a charitable purpose it shall be forever devoted to that purpose, whether or not the particular donee continues to exist. If the donee ceases to exist, the property may be devoted to a kindred charity; one that is, "as near as may be" to the charity contemplated by the donor. The purpose of the doctrine was to prevent the failure of a charitable trust.

(citations omitted).

8. *See, e.g., St. Joseph's Hospital v. Bennett*, 281 N.Y. 115, 22 N.E.2d 305 (1939).

9. The N-PCL defines historic dollar value as “the aggregate fair value in dollars of (i) an endowment fund at the time it became an endowment fund, (ii) each subsequent donation to the fund at the time it is made, and (iii) each accumulation made pursuant to a direction in the applicable gift instrument at the time the accumulation is added to the fund.”

N-PCL § 102 (a) (16).

10. N-PCL § 513 (c), (d). *See also* “Advice for Not-For-Profit Corporations on the Appropriation of Endowment Fund Appreciation,” available on the Charities Bureau’s website at <http://www.oag.state.ny.us/bureaus/charities/pdfs/endowment.pdf>.

11. EPTL § 8-1.1(c) (1) provides:

(c) (1) The supreme court and, where the disposition is made by will, the surrogate’s court in which such will is probated have jurisdiction over dispositions referred to and authorized by paragraphs (a) and (b), and whenever it appears to such court that circumstances have so changed since the execution of an instrument making a disposition for religious, charitable, educational or benevolent purposes as to render impracticable or impossible a literal compliance with the terms of such disposition, the court may, on application of the trustee or of the person having custody of the property subject to the disposition and on such notice as the court may direct, make an order or decree directing that such disposition be administered and applied in such manner as in the judgment of the court will most effectively accomplish its general purposes, free from any specific restriction, limitation or direction contained therein; provided, however, that any such order or decree is effective only with the consent of the creator of the disposition if he is living.

12. *See, e.g., Matter of Nurse*, 35 N.Y.2d 381, 362 N.Y.S.2d 441 (1974); *Matter of Bowne*, 11 Misc. 2d 597, 173 N.Y.S.2d 723 (Sur. Ct. N.Y. County 1958).

13. EPTL § 8-1.1 (c) (1) (“any such [*cy pres*]order or decree is effective only with the consent of the creator of the disposition if he is living”).

14. *Cy pres* relief may also be granted to release or modify a donor-imposed restriction on the use of charitable funds. See Funds With Restrictions on Use, main text at pp. 3-4.

15. Although N-PCL § 202 (a) (5) provides that a not-for-profit corporation has the power to “sell, convey, lease, exchange, transfer or otherwise dispose of . . . all or any of its property,” this does not obviate the need for court approval where such approval is otherwise required by law, as in EPTL § 8-1.1 (c) (1) and N-PCL § 522 (b). *See also* N-PCL §§ 510-11 (requiring court approval, on notice to the Attorney General, for the sale, lease, exchange or other disposition of all or substantially all of the assets of a Type B or Type C not-for-profit corporation).

16. See, e.g., *Matter of Othmer (Long Island College Hospital)*, 185 Misc. 2d 122, 710 N.Y.S.2d 848 (Sur. Ct. Kings County 2000); *Matter of Othmer (Long Island College Hospital)*, 12 Misc. 3d 919, 815 N.Y.S.2d 444 (Sur. Ct. Kings County 2006); *Matter of Polytechnic University*, 12 Misc. 3d 414, 812 N.Y.S.2d 304 (Sur. Ct. Kings County 2006); *Matter of Polytechnic Institute of New York University*, 24 Misc.3d 1249(A), 2009 WL 2948492 (Sur. Ct. Kings County 2009).

17. See also text accompanying Note 4, above.

18. The term “institutional fund” is defined in N-PCL § 102 (a) (17) and includes funds for the exclusive use, benefit or purposes of a not-for-profit corporation, held either by the corporation itself or by a person or entity to whom the corporation has delegated authority over the fund. Trust funds managed by a for-profit trustee and trusts with non-charitable beneficiaries are excluded. See N-PCL § 102 (a) (17) for the complete definition of “institutional fund.”

19. A restriction on the use or investment of an institutional fund (as defined in N-PCL § 102 (a) (17)) may be released with court approval, on notice to the Attorney General, pursuant to N-PCL § 522 (b), if the donor is not available to provide a written consent under N-PCL § 522 (a). A release under N-PCL § 522 (b), however, “may not change an endowment fund to a fund that is not an endowment fund.” *Id.* The release of an endowment restriction (that is, a restriction on expenditure) requires *cy pres* relief pursuant to Estates, Powers and Trusts Law (“EPTL”) § 8-1.1 (c) (1). See also text accompanying Notes 22 and 23, below.

20. The application must be made to the New York Supreme Court in the judicial district where the corporation has its office or principal place of business, or, in the case of gifts made by will, to the Surrogate’s Court where the will was probated. N-PCL § 522 (b).

21. N-PCL § 522 (b) provides:

(b) If written consent of the donor cannot be obtained by reason of his death, disability, unavailability, or impossibility of identification, the governing board may apply in the name of the corporation (i) to the supreme court of the judicial district wherein the corporation has its office or principal place of carrying out the purposes for which it was formed, or (ii) where the applicable gift instrument is a will, to the surrogate’s court in which such will is probated, for release of a restriction imposed by the applicable gift instrument on the use or investment of an institutional fund. The attorney general shall be notified of the application and shall be given an opportunity to be heard. If the court finds that the restriction is obsolete, inappropriate, or impracticable, it may by order release the restriction in whole or in part. A release under this paragraph (b) may not change an endowment fund to a fund that is not an endowment fund.

As to the similarity of the *cy pres* and N-PCL § 522 (b) standards, see *Alco Gravure, Inc. v. Knapp Foundation*, 64 N.Y.2d 458, 467, 490 N.Y.S.2d 116, 121 (1985), where the Court noted:

EPTL article 8 authorizes the Supreme Court or, as to a disposition by will, the Surrogate's Court, to direct how charitable funds shall be administered when the purpose for which originally given or bequeathed becomes "impracticable or impossible" (EPTL 8-1.1 [c], [d]), 6 and N-PCL 522 (which is a modified version of the Uniform Management of Institutional Funds Act, see, 1978 McKinney's Session Laws of NY, at 1774) incorporates similar provisions in that law.

Cf. Matter of Multiple Sclerosis Service Organization of New York, Inc. (New York City Ch. of Nat'l Multiple Sclerosis Soc'y), 68 N.Y.2d 32, 39 n.5, 41, 505 N.Y.S.2d 841, 844 n.5, 845 (1986).

22. N-PCL § 522 (b).

23. N-PCL § 522 (a) provides:

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