

# PROFESSIONAL TAX & ESTATE PLANNING NOTES

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## Changing Donor-Imposed Restrictions: *Cy Pres* and Equitable Deviation

### Questions about charitable giving?

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Almost as long as there have been gifts to charity, there have been donor-imposed restrictions that either fail or become outdated in some other way. The reasons for this are many: advances in medical science, evolution in social mores, changes in the law or economic theory, severe financial hardship in an organization or a community, and so forth. In the future, it is possible that technological breakthroughs, climate change, terrorism, political upheaval, and other developments will create changed circumstances that few today would imagine. If a donor is able and willing to consent to changes in a gift restriction in order to address these developments, no legal issue is presented. This was the topic of the March 2013 issue of *Professional Notes*. But when the donor has died or is a corporation that has gone out of business, or if the donor refuses to agree to a

change, a legal remedy is usually needed in order to deal with an outdated restriction.

Lawyers typically learn in a law school trusts & estates class about the doctrine of *cy pres*, sometimes called the “doctrine of changed circumstances,” and that is certainly a good place to start the conversation. But *cy pres*, fashioned centuries ago by courts of equity to deal with the administration of charitable trusts, has several notable offspring, starting with the closely related doctrine of equitable deviation. Those two ancient doctrines are generally codified today as part of trust law—in New York, for example, in the Estates, Powers and Trusts Law (EPTL). Nonprofit corporations are typically subject to a similar but slightly different set of *cy pres* and equitable deviation rules. In New York, those rules are contained in the Not-for-Profit Corporation Law (NPCL).

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This issue of *Professional Notes* provides an overview of *cy pres* and the related rules that govern a donor-restricted charitable gift when an organization is unable to obtain the donor’s consent to lift or modify a restriction that has become unworkable or unwise. (Board-restricted funds are not covered in this issue, because unilateral board action is ordinarily sufficient to lift or modify a board-imposed restriction.)

The next issue of *Professional Notes* will consider how a community foundation—with its “variance power” to address changed circumstances—provides an efficient and flexible alternative to *cy pres* and equitable deviation when literal compliance with a gift restriction is no longer possible or desirable.

## BACKGROUND

### The Doctrine of *Cy Pres*

The term *cy pres* is shorthand for the Norman French phrase “*cy pres comme possible*,” which in English means “as near as possible.” The roots of the doctrine of *cy pres* are found in cases in England from the Middle Ages, and *cy pres* cases became relatively numerous after the dissolution of the monasteries under King Henry VIII and the accompanying need to find new purposes for hundreds of charitable trusts (“chantries”) whose original charitable purpose (the saying of certain Roman Catholic masses) had become illegal in Reformation England.<sup>1</sup> The classic *cy pres* analysis involved both a finding that the donor had a general intent (beyond the specific charitable purpose that had become illegal or, in some cases, impossible to fulfill) and the identification of an alternative purpose that would, “as nearly as possible,” effectuate the failed charitable purpose.

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**Evolution of the Standard.** In a classic 20<sup>th</sup> century formulation of the *cy pres* doctrine, legal scholars recognized a shift away from earlier attempts to replicate a donor’s intentions “as nearly as possible” and framed the rule simply with reference to finding another purpose that was within the donor’s “more general charitable intent”: “If property is given in trust to be applied to a particular charitable purpose, and it is or becomes impossible

or impracticable or illegal to carry out the particular purpose, and if the settlor manifested a more general intention to devote the property to charitable purposes, then the trust will not fail but the court will direct the application of the property to *some charitable purpose which falls within the more general charitable intent of the settlor.*”<sup>2</sup> Hence, the term *cy pres* has become something of a misnomer today; the literal meaning of the original Norman French phrase (“as near as possible”) is not in fact the standard a modern court would apply when fashioning a so-called *cy pres* remedy.

Further developments have occurred in this century, with the recognition that there is a new category of circumstances in which *cy pres* relief should be available: those situations in which continued adherence to a donor restriction would be wasteful.<sup>3</sup> It is important to note, however, that state law codifications of *cy pres* do not necessarily follow the uniform laws or restatements. New York, for example, has adopted a wastefulness standard for *cy pres* and equitable deviation under the NPCL, but not under the EPTL.

**Impossibility, Illegality, Impracticability, and Wastefulness.** For the most part, the “impossibility” or “illegality” of adhering to a donor’s restriction is a straightforward matter. For example, if the donor specified that a charitable trust fund was to support the

<sup>1</sup> See generally Jones, *History of the Law of Charity, 1532-1827* (1986).

<sup>2</sup> Restatement (2d) of Trusts, Section 399 (1959) (emphasis added).

<sup>3</sup> Restatement (3d) of Trusts, Section 67 (2003); Unif. Trust Code Section 413(a). See also *In re Estate of Buck*, No. 23259 (Cal. Super. Ct. Marin County, Aug. 15, 1986).

Department of Home Economics at a university, and the university eliminates not only the department but also any specialized area of study focused on home economics, then adherence to the charitable purpose has become impossible.<sup>4</sup> Similarly, it would be illegal for an institution to adhere to a restriction requiring that holders of an endowed position not be African-American.<sup>5</sup>

Equitable deviation—closely related to *cy pres*—is the doctrine fashioned by courts of equity to deal with administrative or procedural restrictions imposed by a donor, rather than restrictions on charitable purpose.

The existence of “impracticability,” on the other hand, is usually not so self-evident, in that it requires the court to make a finding that, due to circumstances not foreseen by the donor, continued adherence to his restrictions would permanently defeat his charitable intent. It would be impracticable, for instance, to adhere to a donor’s requirement that a relatively modest bequest be used to establish a new foundation to support scholarships if the costs of establishing and operating the foundation would erode the bequest and ultimately defeat the intended purpose of aiding needy and worthy students; instead, such a bequest could be redirected to an existing charity already administering a scholarship program.<sup>6</sup> The impracticability standard could also serve as the basis for permitting an institution on the verge of insolvency to invade or borrow from an endowment fund in order to pay expenses needed to launch a financial and/or program transformation.<sup>7</sup>

The “wastefulness” standard awaits significant case law. It will be of interest to see whether courts apply an economic or efficiency analysis (e.g., reasoning that a restriction may be modified for wastefulness simply because adherence to it is no longer an economically efficient allocation of limited resources) or apply a more objective analysis grounded in donor intent (e.g., reasoning that a restriction may be modified for

wastefulness only if the assets have appreciated dramatically since the gift was made and only to the extent that the appreciation exceeds the amount that could reasonably be applied for the original purpose).

### The Doctrine of Equitable Deviation

Equitable deviation is closely related to *cy pres*. It is the doctrine fashioned by courts of equity to deal with

administrative or procedural restrictions imposed by a donor, rather than restrictions on charitable purpose. Broadly speaking, a court may apply equitable deviation where compliance with an administrative provision of a trust is “impossible or illegal” or when, as a result of circumstances not known to the donor or anticipated by him, compliance would “defeat or substantially impair the accomplishment of the purpose of the trust.”<sup>8</sup> Unlike *cy pres*, equitable deviation does not require a finding of the donor’s general charitable intent. Equitable deviation is most often used to modify or remove restrictions that a donor placed on the sale or investment of donated property.

Distinguishing between equitable deviation and *cy pres* is not always easy, because in many cases, the restriction can be characterized both as purpose-related and administrative. In 1992, a Pennsylvania court applied the doctrine of equitable deviation as the basis for approving a release from certain restrictions on the loan of artwork by the Barnes Foundation. The court found that the restrictions disallowing the lending and removal of paintings from the premises of the Barnes were administrative only, and therefore the doctrine of equitable deviation could be applied to lift them.<sup>9</sup> Critics questioned whether the restrictions were merely administrative: Were the restrictions instead integral

<sup>4</sup> See *In re Matter of Kraetzer*, 119 Misc. 2d 436 (Surr. Ct. Kings Co. 1983).

<sup>5</sup> See *Coffee v. William Marsh Rice University*, 408 S.W.2d 269 (Tex. Civ. App. 1966).

<sup>6</sup> See *Matter of Tauber*, 33 Misc.3d 1224A (Surr. Ct. Nassau Co. 2011).

<sup>7</sup> See *In re Estate of Othmer*, 710 N.Y.S.2d 848 (Surr. Ct. N.Y. Co. 2000).

<sup>8</sup> Restatement (2d) of Trusts, Section 381 (1959).

<sup>9</sup> See *In re Barnes Foundation*, Slip. Op. No. 58,788 (Pa. C.P. Ct. Montgomery Co. 1992). See also *In re Barnes Foundation*, 683 A.2d 894 (Pa. Super. 1996) and *In re Barnes Foundation*, 2004 Pa. Dist. & Cnty. Dec. LEXIS 344 (2004).

to the donor's charitable purpose in establishing the Barnes as an educational institution capable of fulfilling its educational mission through the enduring availability of its art collection? The grounds for *cy pres* relief are generally viewed to be more stringent than the grounds for equitable deviation, so a court's willingness to treat a donor's restriction as administrative is almost always helpful to an organization that is seeking judicial relief due to changed circumstances.

### Judicial Relief vs. Interpretation

One hallmark of the doctrines of *cy pres* and equitable deviation is that (with the exception of a recent innovation for "small, old funds,"<sup>10</sup> discussed below and in the March 2013 issue) these doctrines are of no effect without a court proceeding and judicial action. However, it may be possible in some cases for an organization and its legal counsel to arrive at a construction of the terms of a charitable gift that allows flexibility without need of going to court. For example, if the terms of a bequest say that it is to endow "a soup kitchen" in a particular city, and the fund grows to such an extent that it will support multiple soup kitchens in that city, it may be possible, without need of a *cy pres* or equitable deviation proceeding, to interpret the bequest to permit multiple soup kitchens. However, it probably would not be possible to interpret such a gift to cover the funding of soup kitchens outside the specified city or the funding of a homeless shelter.

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### A DUAL SYSTEM

Like many states, New York has codified a dual system for the doctrines of *cy pres* and equitable deviation, one under trust law and one under the nonprofit corporate law. The systems are similar but different.

### Trusts

EPTL Section 8-1.1(c) governs *cy pres* and equitable deviation for New York charitable trusts as well as those circumstances when relief from donor-imposed restrictions is not available to a not-for-profit corporation under the NPCL. EPTL Section 8-1.1(c) empowers a court to remove or modify a restriction on a charitable gift "whenever it appears to the court that circumstances have so changed since the execution of an instrument making a disposition for [charitable] purposes as to render impracticable or impossible a literal compliance with the terms of such disposition." The court, on application of the trustee, may direct that "such disposition be administered and applied in such manner as in the judgment of the court will most effectively accomplish ... [the] general purposes" of the disposition.<sup>11</sup> If a donor is living, a New York court must obtain the donor's consent before modifying or removing the restriction. Notably, EPTL Section 8-1.1(c) is written broadly enough to encompass petitions both for a change in the charitable purpose of a fund (*cy pres*) and a change in the requirements concerning its administration (equitable deviation). It does not mention illegality as a predicate for relief, although illegality is arguably subsumed within the concepts of impossibility and impracticability.

<sup>10</sup> See Uniform Prudent Management of Institutional Funds Act (2006), Commentary, Section 6(d) (available at [www.upmifa.org](http://www.upmifa.org)) (using the term "small, old funds").

<sup>11</sup> EPTL Section 8-1.1(c).

## Not-for-Profit Corporations

New York, like virtually every other state, has adopted the Uniform Prudent Management of Institutional Funds Act, known in its unique New York incarnation as NYPMIFA. As explained in previous issues of *Professional Notes*, NYPMIFA brought many changes to the NPCL.<sup>12</sup> Among other changes was a re-codification—and fairly substantial revision—of the doctrines of *cy pres* and equitable deviation as applied to restricted gifts held by New York’s not-for-profit corporations (including when they are serving as trustees of a wholly charitable trust).<sup>13</sup> *Cy pres* and equitable deviation proceedings brought under NYPMIFA must be on notice to the donor, if available, and the attorney general, both of whom must also be given an opportunity to be heard. Notice to the donor is limited to the actual donor and anyone he may have designated in the gift instrument to act in his place; executors, heirs, successors, assigns, transferees, and distributees are expressly excluded.<sup>14</sup>

Under prior law (prior NPCL Section 522), the board of a donee organization could release a donor’s restriction on the use or investment of a charitable gift without going to court, provided the donor consented in writing to the release.<sup>15</sup> This type of relief was limited to lifting restrictions; it could not be used to make modifications or to substitute different restrictions. If the donor was deceased or otherwise unavailable, the donee organization could petition the court to release a restriction, if the restriction had become “obsolete, inappropriate or impracticable” and with the proviso that neither a donor nor a court could grant a release

Under NYPMIFA (NPCL Section 555), a New York not-for-profit corporation may obtain either the release or modification of gift restrictions with the donor’s consent.

under the NPCL that would convert an endowment fund into a non-endowment fund.<sup>16</sup> To accomplish such conversion to a non-endowment fund, it was necessary to commence a *cy pres* proceeding under the EPTL.<sup>17</sup> The Section 522 standard for judicial relief (“obsolete, inappropriate or impracticable”) was less stringent than the classic *cy pres* standard under the EPTL, and Section 522 authorized

only the *release* of restrictions under this standard but *not* their modification.

Under NYPMIFA (NPCL Section 555), as explained in the prior issue of *Professional Notes*, a New York not-for-profit corporation may obtain either the release or modification of gift restrictions with the donor’s consent.<sup>18</sup> Even though prior law classed all restricted gifts together and applied one unified standard to all of them, the new law draws a distinction between *cy pres* and equitable deviation.

For *cy pres* cases, unless they are covered by the special rule for “small, old funds” (see next page), NYPMIFA provides that, if a donor is not available or refuses consent to the release or modification of the purpose of a fund or a restriction on its use, an organization may obtain judicial relief if the donor’s purpose or use has become “unlawful, impracticable, impossible to achieve, or wasteful,” so long as any modification is “consistent with” (presumably meaning, not opposed to) the original purposes.<sup>19</sup> (This standard for modification stands in contrast with the narrower standard of the EPTL, where a *cy pres* modification must be something that the judge believes “will most effectively accomplish” the donor’s general purposes.)

<sup>12</sup> See *Professional Notes*, March, July and October 2011.

<sup>13</sup> See NPCL Section 551(e).

<sup>14</sup> NPCL Section 551(a-1).

<sup>15</sup> See prior NPCL Section 522(a).

<sup>16</sup> See prior NPCL Section 522(b).

<sup>17</sup> See prior NPCL Section 522(d).

<sup>18</sup> See NPCL Section 555(a).

<sup>19</sup> NPCL Section 555(c).

Except in the case of “small, old funds,” the NYPMIFA equitable deviation rule is as follows: If a donor is not available or will not grant consent to changing a restriction “regarding the management or investment” of a fund, an organization may obtain a release or modification if adherence to the restriction “has become impracticable or wasteful” or if the restriction “impairs the management or investment of the fund, or if, because of circumstances not anticipated by the donor, a modification of a restriction will further the purposes of the fund.”<sup>20</sup> (This standard for modification also seems less restrictive than the “most effectively accomplish” standard under the EPTL.)

Finally, for “small, old funds” (those valued at less than \$100,000 that were established more than 20 years in the past), a not-for-profit corporation may release or modify a donor-imposed restriction on its own if (a) the organization provides at least 90 days’ notice to the attorney general (and, in certain cases, the donor) and (b) the attorney general does not send the organization a notice of objection within the 90-day period. This self-help *cy pres* may be invoked only if the donor’s restriction is unlawful, impracticable, impossible to achieve, or wasteful; and any resulting modification must be “consistent with” the purposes expressed in the gift instrument.<sup>21</sup>

In some respects, the NYPMIFA formulation of these rules is less flexible than prior law applicable to New York not-for-profit corporations. For example, it eliminates the ability to obtain release of a restriction on grounds that the restriction has become “inappropriate” or “obsolete” and instead applies standards that are

For funds valued at less than \$100,000 established more than 20 years in the past, a not-for-profit corporation may release or modify a restriction on its own if the Attorney General does not object.

closer to the original (and seemingly less flexible) standards for *cy pres* and equitable deviation. This change means that New York not-for-profit corporations may have less scope than they did previously to obtain relief from a donor’s restriction. On the other hand, the NYPMIFA formulation is still *more* flexible in some respects than the EPTL, which still has no “wastefulness” standard, gives the court less latitude to fashion a modification, and does not contain the “self-help” provision for “small, old funds.”

Finally, NYPMIFA “does not limit the application of the doctrine of *cy pres*.”<sup>22</sup> This provision, a holdover from prior law<sup>23</sup> that does not appear in the Uniform Prudent Management of Institutional Funds Act, enables courts to apply EPTL Section 8-1.1(c) to a donor-restricted fund held by a not-for-profit corporation. In the past, the NPCL expressly prohibited the use of its provisions for the purpose of converting an endowment fund into a non-endowment fund, which made it necessary to invoke EPTL Section 8-1.1(c) for this purpose. Invocation of the EPTL was also needed in order to seek a modification rather than a mere release of a restriction.

But resort to the EPTL for either purpose now seems needless. First, NYPMIFA itself authorizes the modification of a donor-imposed restriction (not merely its release, as under prior law). Second, under NYPMIFA’s rules for endowment spending, the old “floor” on endowment spending (i.e., “historic dollar value”) has generally been removed in favor of a rule permitting any appropriation from an endowment fund that is “prudent,” which effectively gives nonprofit

<sup>20</sup> NPCL Section 555(b).

<sup>21</sup> NPCL Section 555(d).

<sup>22</sup> NPCL Section 555(f).

<sup>23</sup> See prior NPCL Section 522(d).

boards, rather than courts, the burden of deciding whether an endowment fund may be spent down or borrowed against. (Arguably, therefore, NYPMIFA has obviated the need to invoke any form of *cy pres* in order to spend down an endowment fund.) Finally, NYPMIFA does not carry forward the old prohibition against using the NPCL to convert an endowment fund to a non-endowment fund. In other words, in cases where an endowment fund may not be spent below historic dollar value, due either to express limitations in the gift instrument or a donor's veto of converting an endowment fund to a NYPMIFA spending standard, NYPMIFA itself (not the EPTL) appears to be the appropriate vehicle for seeking judicial permission to spend (or borrow) below the original dollar value.

### ALTERNATIVES TO CY PRES AND EQUITABLE DEVIATION

The doctrines of *cy pres* and equitable deviation have been the centerpiece of hundreds of legal cases, and the costs are typically borne by the charitable fund whose terms have become outmoded. *See, e.g.* N-PCL Section 513(b) (allowing restricted funds to be used for the “payment of the reasonable and proper expenses” of their own administration). If the fund's purposes are unlawful, wasteful, or impossible to achieve, years of delay in charitable spending and substantial legal bills may ensue while a charity endures the process of securing the necessary approvals from regulators and the courts. As with any litigation, there are risks: that the court will deny the requested relief, that it will exercise its discretion and give relief that is unclear or unhelpful, or that it will condition its ruling on elaborate fact-

If a charitable fund becomes outmoded, years of delay in charitable spending and substantial legal bills may ensue while a charity endures the process of securing the necessary approvals from regulators and the courts.

finding (as happened in the latest iteration of the various Barnes Foundation cases mentioned above).

And there may be cases where a well-considered modernization of terms cannot be effected, simply because of the comparatively narrow circumstances in which a court is empowered to grant *cy pres* or deviation relief. Perhaps a charitable

purpose has not become “unlawful, impracticable, impossible to achieve, or wasteful,” but instead has become undesirable or impractical. In that case, charity would be stuck with the original restrictions, however unwise they may have become, simply because *cy pres* cannot be invoked.

For a donor concerned about the impact of changing circumstances, one alternative is a community foundation such as The New York Community Trust. By law, community foundations must possess a non-judicial “variance power” over their restricted funds. The next issue of *Professional Notes* will consider how the variance power is a useful tool for a donor who desires to create a perpetual restricted fund, but also wants to permit flexibility and avoid the need for costly judicial proceedings under the venerable—and some would say antiquated—doctrines of *cy pres* and equitable deviation.

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## About The Trust

Since 1924, The New York Community Trust has served the needs of donors and nonprofits in the New York area. One of the oldest and largest community foundations, The Trust is an aggregate of funds created by individuals, families, and businesses to support the voluntary organizations that are crucial to a community's vitality.

Grants made from these funds—which number more than 2,000—meet the needs of children, youth, and families; support community development; improve the environment; promote health; assist people with special needs; and bolster education, arts, and human justice.

In addition to reviewing proposals from nonprofit agencies and responding to the grant suggestions of donors, The Trust is alert to emerging issues and develops strategies to deal with them, works collaboratively with other funders and with government, and gets out information to the public. Recent initiatives have included programs that address youth violence, managed health care, immigration, child abuse, and public school reform.

The Trust is governed by a 12-member Distribution Committee composed of respected community leaders. Its staff is recognized for its expertise in grantmaking, financial administration, and donor services. Local divisions are located on Long Island and in Westchester. In 2012, The Trust made grants of \$136 million from \$2.1 billion in assets.

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