

# U.C.L.A. Law Review

## Use of Restricted Assets During a Crisis: Is It Time to Raid the Endowment?

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## I. INTRODUCTION

The laws that govern charities are both progressive and conservative. Given the capacious legal definition of “charity” these laws enable charities to embrace new ideas to meet changing social needs and, therefore, are progressive in the nonpolitical sense of the term. At the same time, the laws governing charities are quite conservative. Fiduciaries, for example, owe their duties of care and loyalty to the stated legal purposes that govern charitable assets, usually regardless of any crisis a charity may face.

The wisdom of charities law in requiring fidelity to existing charitable purposes has recently been subject to extensive critique, particularly when charitable purposes were established generations ago or by a philanthropist whose views may not accord with popular conceptions of the common good as expressed through a democratic process or by a particular community meant to be served by a charity.<sup>1</sup> This essay considers the claim that charities should make extraordinary expenditures from their endowments, violating existing restrictions on those assets, to address needs arising from crises.<sup>2</sup> Existing laws only allow charities to modestly increase expenditures from endowment beyond ordinary payouts under some circumstances, such as during a crisis. Charities, however, may not unilaterally change existing purposes that govern assets, including by releasing or relaxing endowment restrictions, even during a crisis. Does the law here make sense? Should endowment restrictions continue to be

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1. There are many critiques of philanthropy and nonprofits. See, e.g., EMMA SAUNDERS-HASTINGS, *PRIVATE VIRTUES, PUBLIC VICES: PHILANTHROPY AND DEMOCRATIC EQUALITY* (2022) (examining philanthropy and equality); RAY D. MADOFF, *IMMORTALITY AND THE LAW: THE RISING POWER OF THE AMERICAN DEAD* 5 (2010) (arguing that the power of the dead exerts costly control over the living in America, particularly through perpetual charitable foundations).
  2. Crises present challenges not only to endowment restrictions, but to restrictions on purposes more broadly. For example, whether and how charities can or should apply assets to purposes other than their own, such as to address the victims of a natural disaster or a local act of violence, or whether to impose environmental, social, and governance (ESG) requirements on investments are also important questions. See *What is Environmental, Social, and Governance (ESG) Investing?*, INVESTOPEDIA (Mar. 22, 2023), <https://www.investopedia.com/terms/e/environmental-social-and-governance-esg-criteria.asp> [<https://perma.cc/C74C-U7ME>] (explaining that ESG “investing refers to a set of standards for a company’s behavior used by socially conscious investors to screen potential investments”).

largely inviolable? The COVID-19 pandemic offers an excellent stress-test of the law and its logic.<sup>3</sup>

This Essay first explains that there are various flexibilities in this otherwise rigid legal structure. For example, although charitable purposes cannot be easily changed, activities in pursuit of required purposes can be.<sup>4</sup> Moreover, the interpretation of a purpose can—and very often does—evolve.<sup>5</sup> But, as to the law, the critics of perpetuity are right: perpetual purposes are a central and deeply embedded feature of the law of charities. Changing charitable purposes, such as amending endowment restrictions, requires legal procedures that may be difficult.

This essay sets out four arguments for adhering to restrictions that tend to justify the law as it is: (1) bias, (2) waste, (3) philanthropic power, and (4) intergenerational efficiency and justice. Short of a crisis that poses an existential threat to the world, fidelity to purposes absent legal permission to change them makes sense. A charity's legal purposes are the promises a charity has made to the public. Promises should be kept. Even during a crisis.

## II. SCOPE AND TERMS

The Restatement of the Law, Charitable Nonprofit Organizations<sup>6</sup> concerns the substantive state law that governs charities, a subset of nonprofits. Like the Restatement, this essay takes as given the basic features of the nonprofit sector and philanthropy more generally, accepting the legitimacy of private giving in the pursuit of public good and the appropriateness of a wide range of legal purposes.<sup>7</sup> However, this essay is narrower than the Restatement as it is concerned only with operating charities (roughly defined as those that provide goods and services) and not grantmaking entities (which often have leeway to redirect funding toward emergency needs). Nonetheless, the arguments that follow may inform

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3. To my knowledge, the question of using endowment for new purposes related to a crisis has not been examined in depth. However, scholars have written at length about the dead hand, including how endowment laws do not make sense and should be reformed. *See, e.g.*, MADOFF, *supra* note 1; Brian Galle, *Pay It Forward? Law and the Problem of Restricted-Spending Philanthropy*, 93 WASH. U. L. REV. 1143, 1147 (2016) (citing Jesse Dukeminier & James E. Krier, *The Rise of the Perpetual Trust* 50 UCLA L. REV. 1303, 1327–39 (2003)).

4. *See* RESTATEMENT OF THE LAW, CHARITABLE NONPROFIT ORGANIZATIONS § 3.01, cmts. 1(b), (c) (Am. L. Inst. 2021) (implying the difficulty in changing a purpose).

5. *See id.*, § 1.01 cmt. d.

6. *See id.*, §§ 1.01–6.05.

7. *See id.*, § 1.01. Definition of Charity.

understanding of state and federal tax laws and of the state laws governing non-charitable nonprofits, which include a wide array of entities subject to different legal restrictions and benefiting from diverse privileges.

In addition, the term “endowment” is often used imprecisely to mean all of a charity’s financial, investment, and restricted assets. The legal meaning of endowment is narrower: Restatement § 2.04 explains, “Endowments are funds that are restricted by the person giving the funds in a manner that—aside from some possible minor exceptions—cannot be unilaterally changed by the charity, and that are not wholly expendable on a current basis.”<sup>8</sup> Although charities sometimes characterize assets as “quasi-endowment,” “board-designated endowment,” or “funds functioning as endowment” to indicate that the assets are not meant for current use, an asset must be subject to an externally imposed restriction made at the time of the donation to be a legally recognized endowment asset.<sup>9</sup>

### III. CALLS FOR ENDOWMENT SPENDING AND THE LAW’S RESPONSE

Over the past few years, the United States has faced repeated crises—including political turmoil and challenges to democracy, the ongoing racial reckoning, the opioid epidemic, economic troubles, and, of course, a pandemic.<sup>10</sup>

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8. According to Comment (a) of Restatement § 2.04:

A charity often holds substantial assets that are meant to be invested for the continuing operation of the charity to advance its purposes. All of those assets are restricted in the sense that they must be used to advance the overall purposes of the charity that holds them, and some may be subject to one or more specific restrictions. Although there are many types of investable assets, it is helpful to distinguish them as either true endowments or other funds, including those that the charity chooses to invest for future use. Endowments are funds that are restricted by the person giving the funds in a manner that—aside from some possible minor exceptions—cannot be unilaterally changed by the charity, and that are not wholly expendable on a current basis. They can include assets subject to one or more specific restrictions created by the terms of a gift instrument or a solicitation by a charity . . . .

*Id.* § 2.04 cmt. a. For a definition commonly adopted by states see, e.g., UNIF. PRUDENT MGMT. OF INSTITUTIONAL FUNDS ACT § 2(2) (UNIF. L. COMM’N 2006).

9. The Financial Accounting Standards Board’s definitions are different from those found in state law. Nonprofits must report assets as either net assets with or without donor restrictions. FINANCIAL ACCOUNTING STANDARDS BOARD, ASU 2016-14 NOT-FOR-PROFIT ENTITIES (TOPIC 958) (2016).

10. See generally David Leonhardt, ‘A Crisis Coming’: *The Twin Threats to American Democracy*, N.Y. TIMES, Sept. 17, 2022, <https://www.nytimes.com/2022/09/17/us/american-democracy->

Charities have not been immune. Throughout the pandemic, charities faced rising costs, labor instability, and other economic challenges.<sup>11</sup> Charities that depend on revenues from events and services, such as arts organizations,<sup>12</sup> schools,<sup>13</sup>

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threats.html [https://perma.cc/36D2-6UCB]; *January 6 Insurrection at the US Capitol*, CNN, <https://www.cnn.com/politics/january-6-insurrection> [https://perma.cc/ZMZ9-3BLX]; Alisa Chang, Rachel Martin & Eric Marrapodi, *Summer of Racial Reckoning*, NPR, Aug. 16, 2020, <https://www.npr.org/2020/08/16/902179773/summer-of-racial-reckoning-the-match-lit> [https://perma.cc/C5B8-UXU7]; Hakeem Jefferson & Victor Ray, *White Backlash is a Type of Racial Reckoning, Too*, FIVETHIRTYEIGHT, Jan. 6, 2022, <https://fivethirtyeight.com/features/white-backlash-is-a-type-of-racial-reckoning-too/> [https://perma.cc/HSB5-9DVQ]; Benjamin Curry & Michael Adams, *Are We in a Recession Yet?*, FORBES, Apr. 19, 2023, <https://www.forbes.com/advisor/investing/are-we-in-a-recession/#:~:text=According%20to%20a%20general%20definition,%2C%20takes%20a%20different%20view> [https://perma.cc/L28M-TDSZ]; *Coronavirus in the U.S.: Latest Map and Case Count*, N.Y. TIMES, Mar. 23, 2023, <https://www.nytimes.com/interactive/2021/us/covid-cases.html> [https://perma.cc/ZFE2-CJU9].

11. See, e.g., Betsy Morris, *While Covid-19 Donations Soar, Other Charities See a Big Hit to Funds*, WALL ST. J. (Aug. 8, 2020), <https://www.wsj.com/articles/while-covid-19-donations-soar-other-charities-see-a-big-hit-to-funds-11596913200> [https://perma.cc/R63C-NNUR] (discussing declining revenues); Alex Gangitano, *Charities Scramble to Plug Revenue Holes During Pandemic*, HILL (Sept. 7, 2020), <https://thehill.com/business-a-lobbying/515154-charities-scramble-to-plug-revenue-holes-during-pandemic> [https://perma.cc/6FSG-9FBH] (discussing that revenue losses for charities are in the billions). See also *Data on How the Pandemic and Economic Crises are Affecting Nonprofits*, NAT'L COUNCIL NONPROFITS, <https://www.councilofnonprofits.org/data-how-the-pandemic-and-economic-crises-are-affecting-nonprofits> [https://perma.cc/X8QL-R32C]; *COVID-19 Negatively Impacting Nearly All Charities*, NONPROFIT TIMES (Apr. 6, 2020), <https://www.thenonprofitimes.com/donors/covid-19-negatively-impacting-nearly-all-charities> [https://perma.cc/KMM8-BWD5] (discussing key findings of a study conducted by the Charities Aid Foundation of America).
12. See Greg Guibert & Iain Hyde, *Analysis: COVID-19's Impacts on Arts and Culture*, COVID-19 RSFLG DATA AND ASSESSMENT WORKING GROUP (Jan. 4, 2021); *The Economic Impact of Coronavirus on the Arts and Culture Sector*, AMS. FOR THE ARTS, <https://www.americansforthearts.org/by-topic/disaster-preparedness/the-economic-impact-of-coronavirus-on-the-arts-and-culture-sector> [https://perma.cc/EF9U-W8JM]; Betsy Morris, *While Covid-19 Donations Soar, Other Charities See a Big Hit to Funds*, WALL ST. J. (Aug. 8, 2020), <https://www.wsj.com/articles/while-covid-19-donations-soar-other-charities-see-a-big-hit-to-funds-11596913200> [https://perma.cc/A7YB-74EF]; AMERICAN ALLIANCE OF MUSEUMS, NATIONAL SURVEY OF COVID-19 IMPACT ON UNITED STATES MUSEUMS (June 2020); SMU NATIONAL CENTER FOR ARTS RESEARCH, COVID-19 IMPACT ON NONPROFITS ARTS AND CULTURE IN NEW YORK CITY (June 26, 2020); Thomas Abruzzo, Laura Deitrick, Christine Jones & Jonathan Gus, *2020 Culture Shift: Measuring COVID-19 Impact on San Diego Arts and Culture Nonprofits*, ARTS & CULTURE (2020), <https://digital.sandiego.edu/mpi-arts/1> [https://perma.cc/W3U2-8837].
13. See Andrew DePietro, *Here's a Look at the Impact of Coronavirus (COVID-19) on Colleges and Universities in the U.S.*, FORBES (Apr. 30, 2020, 5:20 PM), <https://www.forbes.com/>

and hospitals,<sup>14</sup> suffered disproportionately. Charities that provide services for disadvantaged people were swamped by demand.<sup>15</sup>

Yet, at the same time, some charities held enormous sums of money. Although precise numbers are hard to find, when excluding private foundations, which held roughly \$1 trillion in 2020,<sup>16</sup> and including quasi-endowments, nonprofits held over \$700 billion in funds labeled as endowments in 2017.<sup>17</sup> Large university endowments account for more than half of the endowments outside of foundations,<sup>18</sup> roughly \$821 billion in fiscal year 2021,<sup>19</sup> although these estimates include both quasi- and true endowments<sup>20</sup>.

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sites/andrewdepietro/2020/04/30/impact-coronavirus-covid-19-colleges-universities/?sh=219b2a6061a6 [https://perma.cc/K2QG-DD24].

14. See, e.g., <https://oig.hhs.gov/oei/reports/OEI-09-21-00140.pdf>.
15. See U.S. FEDERAL EMERGENCY MANAGEMENT AGENCY, COVID-19'S IMPACT ON THE HUMAN & SOCIAL SERVICES SECTOR (Nov. 13, 2020); STEPHANIE BROOKS HOLLIDAY, SARAH B. HUNTER, ALEX R. DOPP, MARGARET CHAMBERLIN & MARTIN Y. IGUCHI, RAND CORP., EXPLORING THE IMPACT OF COVID-19 ON SOCIAL SERVICES FOR VULNERABLE POPULATIONS IN LOS ANGELES: LESSONS LEARNED FROM COMMUNITY PROVIDERS (2019).
16. See Ben Steverman, *Billionaires Urge Tax Reform to Free \$1 Trillion for Charity*, BLOOMBERG (Dec. 1, 2020, 6:18 AM), <https://www.bloomberg.com/news/articles/2020-12-01/billionaires-urge-tax-reform-to-unlock-1-1-trillion-for-charity> [https://perma.cc/Y9YA-7G9S].
17. See Sandeep Dahiya & David Yermack, *Investment Returns and Distribution Policies of Non-Profit Endowments Funds* 9 (European Corp. Governance Inst. Fin. Working Paper No. 582/2018). This amount may be overstated because it does not separate true endowments from funds restricted by the charity itself, amounts that could legally be used for non-investment purposes.
18. The National Association of College and University Business Officers report for fiscal year July 1, 2019–June 30, 2020 shows 705 schools represented \$637.7 billion in endowment assets. See Kate McCreary & Vanessa Sussman, *In Year Punctuated by Pandemic, Higher Education Endowments Provide More Than \$23 Billion to Support Students, Mission*, NACUBO (Feb. 19, 2021), <https://www.nacubo.org/Press-Releases/2021/Higher-Education-Endowments-Provide-More-Than-23-Billion-to-Support-Students-Mission> [https://perma.cc/P9DB-2AXY] (discussing report findings).
19. See NAT'L ASS'N COLL. & UNIV. BUS. OFFICERS, 2021 NACUBO-TIAA STUDY OF ENDOWMENTS.
20. The percentage of university endowments constituted by quasi-endowment is unclear, and estimates vary a great deal. Some sources suggest that the percentage is as low as twelve percent. See AM. COUNCIL ON EDUC., UNDERSTANDING COLLEGE AND UNIVERSITY ENDOWMENTS 4 (2014). Others report a range of percentages over different years. See Andy Segedin, *Endowments Eyed Closely by Cash-Strapped States*, NON-PROFIT TIMES (May 1, 2016) (reporting twenty-seven percent); Thad D. Calabrese & Todd L. Ely, *Understanding and Measuring Endowment in Public Charities*, 46 NONPROFIT & VOLUNTARY SECTOR Q. 859 (reporting twenty-nine percent); GOV'T ACCOUNTABILITY OFF., POSTSECONDARY EDUCATION: COLLEGE AND UNIVERSITY ENDOWMENTS HAVE SHOWN LONG-TERM GROWTH, WHILE SIZE, RESTRICTIONS, AND DISTRIBUTIONS VARY (GAO-10-393, 2010) (reporting fifty-five percent).

Many stakeholders and some charities themselves have demanded that endowment funds be used for current needs. Both during the pandemic<sup>21</sup> and before,<sup>22</sup> for example, students called on universities to tap endowments to subsidize tuition and raise pay for employees. The arguments meant to justify spending more than the legally-defined prudent payout amounts from endowments vary. In the university context, advocates asserted that it was unjust to charge full tuition when students were receiving inferior educations during the pandemic, and that endowment funds should be used to forestall employee layoffs as well. Outside the university context, charities argued that they should be permitted to use their endowments to avoid insolvency.

Both in general guidance documents<sup>23</sup> and in response to specific requests to increase endowment spending beyond the legally prudent amount, charity

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21. Advocates have argued that endowment should be used to lower tuition for remote education during COVID. See Matthew Harnick, *Partial Refund on NYU Tuition*, CHANGE.ORG, <https://www.change.org/p/nyu-students-request-partial-refund-from-nyu?redirect=false> [<https://perma.cc/4X5G-5NXN>]; Christian Belanger, *University of Chicago Students Begin Tuition Strike, Calling for School to Halve Cost During Pandemic*, HYDE PARK HERALD (Apr. 29, 2020), <https://www.hpherald.com/news/university-of-chicago-students-begin-tuition-strike-calling-for-school-to-halve-cost-during-pandemic/> article\_e44108c2-8a5c-11ea-a61a-03d4c22ed43e.html#:~:text=University%20of%20Chicago%20students%20began,their%20tuition%20without%20trade%20Doffs [https://perma.cc/69XD-79S6]; UChicago for Fair Tuition (@uchicogofairtuition), FACEBOOK (Apr. 28, 2020, 1:17 PM), <https://www.facebook.com/uchicogofairtuition/photos/127576075568938> [https://perma.cc/638K-AGU5]. See also UChicago for Fair Tuition, Tuition Reduction Petition Letter to President Zimmer, Provost Lee and Director Neubauer 3, <https://docs.google.com/document/d/1qUlh71K9om8h5y8b8J02sgC1QJ1p95wphgE1BQYg5EA/edit> [https://perma.cc/9LZH-J978]. For suits against colleges and universities for tuition refunds during the pandemic, see Doug Lederman, *Courts Skeptical on COVID-19 Tuition Lawsuits*, INSIDE HIGHER ED (May 5, 2021), <https://www.insidehighered.com/news/2021/05/06/courts-view-covid-19-tuition-refund-lawsuits-skeptically> [https://perma.cc/R6TA-MREP].
  22. Dillon Jones, *UNL Needs to Invest in Its Students*, DAILY NEBRASKAN (Feb. 8, 2013), [https://www.dailynebraskan.com/opinion/jones-unl-needs-to-invest-in-its-students/article\\_973cfa8-71a9-11e2-9e94-001a4bcf6878.html](https://www.dailynebraskan.com/opinion/jones-unl-needs-to-invest-in-its-students/article_973cfa8-71a9-11e2-9e94-001a4bcf6878.html) [https://perma.cc/BDT4-QMC3].
  23. See, e.g., C.A. DEP'T JUST., CHARITABLE TRUSTS SECTION, CHARITY GOVERNANCE DURING THE COVID-19 PANDEMIC (2020); OFF. N.Y. ATT'Y GEN. CHARITIES BUREAU, GUIDANCE FOR CHARITABLE NONPROFIT ORGANIZATIONS FACING THE CHALLENGES OF THE COVID-19 PANDEMIC 4 (2020); N.H. ATT'Y GEN. OFF., THE COVID-19 OUTBREAK AND CHARITABLE ORGANIZATIONS IN NEW HAMPSHIRE: GUIDANCE REGARDING ENDOWMENT FUNDS 4 (2020); COMMONWEALTH M.A., OFF. ATT'Y GEN., GUIDANCE ON ENDOWMENTS FOR CHARITIES FACING FINANCIAL CHALLENGES DUE TO COVID-19 3 (2020); OFF. ILL. ATT'Y GEN., CHARITABLE TRUST BUREAU GUIDANCE TO CHARITIES DURING THE COVID-19 PANDEMIC (2020). Other state attorney generals addressed charities informally. See, e.g., *Pandemic Will Create Pressure on*

regulators largely rejected these demands.<sup>24</sup> With few exceptions, charities were not permitted to unilaterally release endowment funds or circumvent other donor-imposed restrictions.<sup>25</sup> Absent donor-imposed terms to the contrary,<sup>26</sup> the law that governs endowment assets specifies how funds may be invested, how uses can be changed from one purpose to another, and how much and to what end they are spent. The Restatement § 2.04 explains:

(b) A charity must manage its assets that are held for investment as a prudent investor would in light of the purposes of the charity, in

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- Charities*, OHIO ATT'Y GEN. (Apr. 7, 2020), <https://web.archive.org/web/20200815051426/https://www.ohioattorneygeneral.gov/Media/Newsletters/Nonprofit-news/Spring-2020/Pandemic-Will-Create-Pressure-on-Charities> [<https://perma.cc/M28B-4SPQ>]; *Serving on Nonprofit Board When You Can't Meet in Person*, OR. DEP'T JUST.: CHARITABLE ACTIVITIES (Apr. 23, 2020), <https://www.doj.state.or.us/charitable-activities/laws-guides-for-charities/tips-for-charities/serving-on-nonprofit-board-when-you-cant-meet-in-person> [<https://perma.cc/RP96-NC95>]. Other states released guidance loosening public meeting requirements for many groups, including charities. *See, e.g.*, Guidance on Executive Order No. 20–36 Coronavirus—Public Meetings Requirement Limited Waiver, NEB. ATT'Y GEN., (2020), <https://ago.nebraska.gov/news/attorney-general-guidance-executive-order-no-20-36-coronavirus-%E2%80%94public-meetings-requirement> [<https://perma.cc/E2K7-LNWS>]; KANSAS ATTORNEY GENERAL GUIDANCE (2020), [https://ag.ks.gov/docs/default-source/publications/k-a-r-16-20-1-compliance-with-the-kansas-open-meetings-act-during-an-emergency-declaration.pdf?sfvrsn=9648ac1a\\_20](https://ag.ks.gov/docs/default-source/publications/k-a-r-16-20-1-compliance-with-the-kansas-open-meetings-act-during-an-emergency-declaration.pdf?sfvrsn=9648ac1a_20) [<https://perma.cc/FS2R-BWVT>].
24. States outlined existing tools to address governance challenges such as procedures for electronic meetings, reduced quorum rules, and modifications to board authority to accommodate incapacitated directors. *See, e.g.*, NEB. ATT'Y GEN., *supra* note 23; KANSAS ATTORNEY GENERAL GUIDANCE, *supra* note 23. They also publicized sources of financial relief other than endowment. For example, the Massachusetts Attorney General Guidance suggests consideration of several sources before seeking a modification of restrictions: (1) raising new and unrestricted donations; (2) various federal or state sources; (3) grant funding through COVID-19 relief funds or private foundations; and (4) borrowing and refinancing. COMMONWEALTH M.A., OFF. ATT'Y GEN., *supra* note 23, at 3.
25. “All of a charity’s assets, including those commonly known as ‘unrestricted assets’ or ‘general assets,’ are restricted to the charity’s overall purposes . . . . In addition . . . an asset held by a charity may also be subject to one or more specific restrictions, such as those created by the terms of a gift instrument or solicitation by a charity.” RESTATEMENT OF THE LAW, CHARITABLE NONPROFIT ORGANIZATIONS § 4.01 cmt. a (Am. L. Inst. 2021). *See e.g.*, Jill R. Horwitz interviews with Mary Beckman, Acting Secretary of the executive Office of Health and Human Services for the State of Massachusetts and former Chief of the Non-Profit Organizations/Public Charities Division in the Massachusetts Attorney General’s Office. *See* sources cited *supra* note 23.
26. Specific restrictions sometimes incorporate methods for release or modification if specified conditions occur and procedures are followed. Conditions might include, for example, passage of a certain period of time, meeting a benchmark, or donor consent.



accordance with any valid terms governing the assets in question, and considering any other relevant circumstances.

(c) A charity may appropriate for expenditure or accumulate:

(1) funds in an endowment (A) to the extent the charity determines it to be prudent given the uses, benefits, purposes, and duration for which the endowment was established, (B) in light of the purposes of the charity, and (C) in accordance with any additional, valid terms governing the funds in question.<sup>27</sup>

What does this mean for spending from an endowment? Although under the common law the term “prudence” is not precisely defined, many state statutes set parameters that help determine the amount of spending from an endowment that will be considered a prudent amount. The Uniform Prudent Management of Institutional Funds Act (“UPMIFA”),<sup>28</sup> for example, permits charities to spend from an endowment either in accordance with a donor agreement or, absent an agreement, an amount that is prudent, where prudence is informed by seven factors.<sup>29</sup> Many states specify a prudent rate of expenditure by statute. Almost one-third of states have adopted an optional provision from UPMIFA, including California and New York, which treats expenditures of more than seven percent of the fair market value of an endowment fund as presumptively imprudent.<sup>30</sup> Although such statutes typically allow the charity to rebut this presumption, they generally provide neither a safe harbor nor presumption of prudence if a charity spends below this amount.<sup>31</sup>

During the pandemic, only Pennsylvania increased the permissible top rate of spending from endowments. The state increased the rate from 7 to 10 percent

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27. RESTATEMENT OF THE LAW, CHARITABLE NONPROFIT ORGANIZATIONS § 3.01, cmts. 1(b), (c) (Am. L. Inst. 2021).

28. UPMIFA has been adopted in forty-nine states and Washington, D.C. It governs to charities that are corporations and charitable trusts for which another charity serves as the trustee. It does not govern trusts for which an individual or a bank serves as trustee. See *Prudent Management of Institutional Funds Act*, UNIF. L. COMM'N, <https://www.uniformlaws.org/committees/community-home?CommunityKey=043b9067-bc2c-46b7-8436-07c9054064a3> [<https://perma.cc/MCS5-AKRD>].

29. The factors include duration and preservation of fund, purposes of the institution and fund, general economic conditions, possible effect of inflation or deflations, expected total return, other resources, investment policy. See RESTATEMENT OF THE LAW, CHARITABLE NONPROFIT ORGANIZATIONS § 2.04 cmt. f.

30. See Cal. Prob. Code § 18504(d); N-PCL § 553(d)(1), (2).

31. One exception to this is Ohio’s version of the UPMIFA, which creates an irrebuttable presumption of prudence for annual expenditures of five percent or less. See Ohio Rev. Code § 1715.53.

during calendar years 2020-22 or for fiscal years that ended during those calendar years, subject to preexisting rules that required the board to choose a rate consistent with the long-term preservation of the real value of assets.<sup>32</sup> Otherwise, regulators simply reminded charities of these rules, warning charities not to invade or borrow against principal to address “unanticipated costs and budget shortfalls . . . which is not permitted.”<sup>33</sup> Even borrowing from an endowment was not generally possible,<sup>34</sup> although some regulators signaled a willingness to consider how an endowment could be used as collateral.<sup>35</sup>

Applying existing law meant that charities that were not already spending up to a prudent amount could increase endowment payouts. In some states and under certain conditions, the law permitted charities to unilaterally release restrictions on small, old funds.<sup>36</sup> In addition, regulators advised financially

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32. See Act of July 23, 2020, Pub. L. No. 681–71, Pa. Laws, available at <https://www.legis.state.pa.us/cfdocs/legis/li/uconsCheck.cfm?yr=2020&sessInd=0&act=71> amending <https://www.legis.state.pa.us/WU01/LI/LI/CT/HTM/20/20.HTM>; 20 Pa. Stat. and Cons. Stat. Ann. § 8113(c)(3) (West 2023). For further discussion of the Act, see C. Thomas Work & Jennifer L. Nevins, *Stevens & Lee Consults with Pennsylvania Legislature to Provide COVID-related Financial Relief to Nonprofits*, STEVENS & LEE: ALERTS AND NEWSLETTERS (July 28, 2020), available at <https://www.stevenslee.com/stevens-lee-consults-with-pennsylvania-legislature-to-provide-covid-related-financial-relief-to-nonprofits> [<https://perma.cc/E5Q2-LNC9>].

33 C.A. DEP’T JUST., CHARITABLE TRUSTS SECTION, *supra* note 23, at 3–4.

34. “Borrowing” requires more than one party, a lender and a borrower. A charity that removes funds from their endowment to use for its own purposes is spending, not borrowing. However, in granting permission for a charity to make a distribution to itself from an endowment in an amount above the prudent amount using its equity powers, a court may require the charity to commit to paying that amount, or that amount plus interest, to the endowment over a specified time, thus structuring the appropriation as if it were a loan. See, e.g., COMMONWEALTH M.A., OFF. ATT’Y GEN., *supra* note 23, at 3.

We recognize that during the COVID-19 crisis, an institution may have an immediate need for funds. It is the Division’s position that emergency access to endowment funds does not abrogate the requirement that such action be sanctioned by the appropriate court. We encourage institutions and their counsel to carefully consider their fiduciary obligations under governing statutory and common law standards, including those articulated in the Restatement of the Law of Charitable Nonprofit Organizations.

COMMONWEALTH M.A., OFF. ATT’Y GEN., *supra* note 23, at 5 n.9.

35. OFF. N.Y. ATT’Y GEN. CHARITIES BUREAU, *supra* note 23.

36. For example, in California, charitable organizations that hold endowment funds over twenty years old and have a total value of less than \$100,000 may release or modify the restrictions on the endowment funds sixty days after written notice to the attorney general and the donor. CAL. PROB. CODE § 18506(d). In the notice to the attorney general, the nonprofit must show

struggling charities that held assets to transfer them to other charities that could carry on the same purposes.<sup>37</sup>

Otherwise, charities in need were required to seek external permission to release restrictions. In some states and under certain conditions, donors may consent to the removal of a specific restriction, including a restriction that the donation must be treated as endowment,<sup>38</sup> and charities sought permission.<sup>39</sup> However, donor release is an impractical method for large endowments based on thousands of donations over the long term.

Charities that could not pursue any of these paths had to comply with the law by turning to the courts. As explained in the Restatement § 4.03, aside from these other paths, a specific restriction on a charitable asset may be released or modified only:

as authorized in a judicial proceeding to which the state attorney general is a necessary party and in which the court applies the doctrine of *cy pres* to modify the purposes to which the asset must be devoted . . . or the doctrine of deviation to modify an administrative term governing the asset . . .<sup>40</sup>

The doctrine of *cy pres* allows a court to modify a purpose to which charitable assets must be devoted: “If it is or becomes unlawful, impossible, impracticable, or

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how the endowment has become unlawful, impossible, impracticable, or wasteful to operate with the restrictions. *Id.* The notice should also propose an alternate use consistent with the charitable purposes expressed in the gift instrument. *Id.*

37. See, e.g., OFF. N.Y. ATT’Y GEN. CHARITIES BUREAU, *supra* note 23, at 5.

38. See generally, RESTATEMENT OF THE LAW, CHARITABLE NONPROFIT ORGANIZATIONS § 4.04 Release or Modification of a Specific Restriction on a Charitable Asset (Am. L. Inst. 2021). Uniform laws, such as the Uniform Trust Code and the Uniform Prudent Management of Institutional Funds Act, state variants of those acts, and non-uniform statutes specify the specific mechanisms by which various forms of restrictions may be released, including by a donor. New York guidance states that “restricted assets (assets designated by donors for special purposes, or assets received from a specific fundraising campaign for a specific purpose) must be used for the designated purpose unless the donor consents to a release of the funds for other purposes.” Otherwise, such as in the case of a deceased donor or one who rejects a request to release a restriction, the charity must apply to the New York Supreme Court to change the purposes to which assets must be devoted under the doctrine of *cy pres*. OFF. N.Y. ATT’Y GEN. CHARITIES BUREAU, *supra* note 23.

39. See e.g., Jill R. Horwitz interview with Mary Beckman, Acting Secretary of the executive Office of Health and Human Services for the State of Massachusetts and former Chief of the Non-Profit Organizations/Public Charities Division in the Massachusetts Attorney General’s Office (taken as part of many conversations between Horwitz and other state regulators over the course of the pandemic).

40. RESTATEMENT OF THE LAW, CHARITABLE NONPROFIT ORGANIZATIONS § 4.03(c) (Am. L. Inst. 2021).

wasteful for a charity to carry out its purposes, the court should direct application of the assets or an appropriate portion thereof to charitable purposes that reasonably approximate the designated purposes.”<sup>41</sup> In fact, the Restatement explains that fiduciaries are required to seek cy pres if a charity’s assets exceed the amount needed to achieve prescribed purposes.<sup>42</sup>

The doctrine of deviation, which allows the court to modify administrative terms governing the asset rather than the purposes to which the asset must be devoted, is an additional tool which a charity may apply to alter restrictions. The conditions under which it is appropriate for a court to apply the doctrine are similar to those for cy pres in that it allows for deviation if “(1) compliance with the term has become unlawful, impossible, impracticable, or wasteful” but also allows for deviation if “(2) the term impairs the prudent management or investment of an asset; or (3) circumstances exist that had not been anticipated by the donor.”<sup>43</sup> Deviation is a more flexible doctrine than cy pres in that there are two additional categories conditions under which a restriction may be released. On the other hand, it is a less flexible doctrine than cy pres, however, in that the deviation must “further the purposes governing the asset.”<sup>44</sup>

#### IV. THE PROBLEMS OF SPECIAL RULES FOR SPECIAL CIRCUMSTANCES

The arguments for allowing charities unilateral authority to use endowments to serve current needs during a crisis are intuitive. The needs of charities, their beneficiaries, and their stakeholders can be severe.<sup>45</sup> For some charities, the organization’s survival depends on access to funding. In others, the endowment is enormous, perhaps shockingly so in a world with great need. Therefore, it would seem to make sense to let charities treat endowments as rainy-day funds. Yet, on close inspection, a policy allowing charities to unilaterally invade endowments is

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41. RESTATEMENT OF THE LAW, CHARITABLE NONPROFIT ORGANIZATIONS § 3.02 The Doctrine of Cy Pres (Am. L. Inst. 2021).

42. The Restatement gives the example of a small botanical garden designed for small plants holding an endowment that exceeds the needs of the garden. RESTATEMENT OF THE LAW, CHARITABLE NONPROFIT ORGANIZATIONS § 3.03 illus. 3 (Am. L. Inst. 2021).

43. RESTATEMENT OF THE LAW, CHARITABLE NONPROFIT ORGANIZATIONS § 3.03 The Doctrine of Deviation (Am. L. Inst. 2021).

44. *Id.*

45. *One-third of U.S. Nonprofits May Close as Pandemic Upends Finances, Study Warns*, CBS NEWS (Mar. 3, 2021), <https://www.cbsnews.com/news/one-third-of-u-s-nonprofits-in-jeopardy-as-financial-needs-escalate-during-pandemic-study-finds> [<https://perma.cc/KAJ8-5WVE>].

not in the interests of charity or, ultimately, the public benefit meant to be served. The law as it stands is good policy.

The law mandates that charitable purposes advance the public interest only in a general sense; it is catholic with respect to purposes a charity may adopt and includes few limitations such as<sup>46</sup> that the purpose must not be illegal or against fundamental public policy. Thus, charitable purposes and activities are not limited to fulfilling society's most pressing needs, even when charitable assets could fulfill those needs when government falls short. Having adopted a purpose or a specific restriction on an asset, the charity must advance that purpose or restriction. In the language of for-profit organizations, charitable purposes—not charities—*own* the assets. For these reasons, if a charity were to donate assets to another charity with an unrelated purpose, it would not be advancing its own purposes and, therefore, may well violate the duties of both the donor-charity and its fiduciaries.

Moreover, in a legal system in which we allow private property and use the tax system to redistribute where needed, we do not generally allow outsiders to determine how private parties use their assets. This is true even if those outsiders have excellent ideas, including ideas for the application of privately held assets to solve serious social problems. More colorfully, many of us would spend Elon Musk's fortune in different ways than he does. But beyond our role in voting or otherwise advocating for public policies that would limit the powers of billionaires, we do not get a say. Our legal system similarly does not allow private parties—including charities, current beneficiaries, and outsiders—to change the purposes to which restricted assets must be devoted absent following the legal processes. Doing so would be akin to allowing one private party to commandeer the assets of another.

Furthermore, once the government has authorized a charity's purposes, and with the exception of collecting any taxes owed, its oversight of a charity's obligations related to its charitable status is primarily confined to ensuring the charity advances the purposes to which its assets must be devoted. Of course, the government may wish to limit philanthropy or require certain kinds of charitable spending,<sup>47</sup> or it may choose to tax certain charitable assets, as Congress recently

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46. See RESTATEMENT OF THE LAW, CHARITABLE NONPROFIT ORGANIZATIONS § 1.01 cmt. h (Am. L. Inst. 2021).

47. It is far beyond the scope of this Essay to consider whether the charitable sector undermines democracy. As private wealth grows and the power of philanthropists expands, there are convincing examples that some charitable activities do undermine democracy. However,

did when it decided that the mega-endowments of some universities were too big and imposed an “Endowment Tax” on a subset of them.<sup>48</sup> But such major decisions are best made as part of a democratic process, not by private fiat during an emergency.

Under our current legal system, neither private parties—including charities and beneficiaries—nor the public—via democratic processes—can authorize a charity to unilaterally change its purpose. Given our system of allowing private parties to act in accordance with their own ideas of the public benefit and to impose restrictions on donations, there are several convincing justifications for the current law. Here, I outline four reasons—(A) bias, (B) waste, (C) philanthropic power, and (D) intergenerational efficiency and justice—that justify preventing charities from using endowment assets to meet current needs, even during a crisis when the case for using endowment is most compelling.

### A. Self-interest and Bias Toward the Present

Suspending rules during a crisis heightens the risk of misguided actions driven by self-interest or bias. Although one might think that charities and their current fiduciaries are in the best position to appreciate their needs, people are often not good judges of the relative extremity of their own circumstances. Recency bias and the availability heuristic have historically led people to claim that they face unprecedented times<sup>49</sup> technologically, politically, and socially. Even since the Restatement was published, the United States has encountered several unprecedented emergencies—the January 6 insurrection, the overturning of *Roe v. Wade*, further warming of the planet—not to mention the pandemic. Given the human tendency to overvalue personal and recent experiences, current fiduciaries are just as likely to overvalue the extremity of current circumstances. Future needs, even grave needs, are merely hypothetical whereas current ones are more salient and deeply felt.

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charitable activity also supports democracy and allows for private expressions in the public interest that creates valuable experiences and infrastructure by which people live meaningful lives. In other words, it is complicated in a second-best world.

48. Roughly, the Tax Cuts and Jobs Act of 2017 imposed a 1.4% excise tax on net investments of very wealthy private universities. See I.R.C § 4968. Guidance in 2020 excludes students whose tuition is paid via various grants and scholarship. See Kery Murakami, *Treasury Modifies Endowment Tax Rules*, INSIDE HIGHER ED (Sept. 20, 2020), <https://www.insidehighered.com/quicktakes/2020/09/21/treasury-modifies-endowment-tax-rules> [https://perma.cc/3ZE5-M9XH].

49. A simple Westlaw search of North American newspapers found the word “unprecedented” 8,480 times. Here is the Westlaw search entry: ATLEAST1(unprecedented) & DA (aft 02-11-2022).

## B. Waste

Allowing financially strapped charities to access endowments for current spending or to serve as collateral for new debt would likely lead to waste. Managers predictably want to save their own organization, even when their organization's purposes could be better advanced by closing and transferring the remaining funds to another, healthier organization. Under such circumstances preserving an entity would come at the expense of advancing the purposes that entity is obligated to advance. For instance, assets used to forestall bankruptcies, some of which will be inevitable, leave fewer (or no) assets to transfer to another charity which could have continued advancing the same charitable purposes of the bankrupt charity, including serving those in great need during a crisis. Unserved beneficiaries and, ultimately, the public, bear the burden of this form of waste. Preventing charities from unilaterally relieving restrictions to protect a particular charity, therefore, may well protect assets that will serve beneficiaries and the underlying charitable purposes.

## C. Philanthropic Power and the Dead Hand

Scholars have identified multiple concerns about the influence of powerful donors<sup>50</sup> and the dead hand of previous generations continuing to control the living. In analogizing charitable restrictions to voting, Ray Madoff explains, “the law does not allow [people] . . . to cast ballots for elections occurring after their death . . . . [We] are skeptical about people’s ability to make good decisions for the future when they are limited in their knowledge to the world of the present.”<sup>51</sup>

There are at least two powerful rejoinders to this argument. First, sometimes donors, even wealthy donors, restrict assets to advance good in forward-looking ways before the electorate is ready to do so. Second, restricted endowments can have the paradoxical effect of diminishing donor control as the passage of time smooths the sharp edges of restrictive terms. Broad purposes, such as education and health, come to mean different things to successive generations. One consequence of the evolution of language is that changes to purposes that would have required a *cy pres* proceeding at a prior time later only require a deviation process or no process at all. For example, expanding the pool of scholarship recipients to a more inclusive class than “for promising young Christian men” becomes easier over time.

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50. See, e.g., SAUNDERS-HASTINGS, *supra* note 1.

51. MADOFF, *supra* note 1, at 5.

Moreover, because the donors who restricted their gifts eventually pass on, charities may slowly change the focus of their activities in pursuit of existing purposes without formally change those purposes. With no donor to bring a legal claim, to alert the charity regulator of a possible violation of a term, or to exert informal pressure on the charity, charities have freedom to change the emphasis of their activities, including addressing crises. Continuous small changes to activities over time can slowly lead to an effective change of purposes.

The flip side of this observation is that granting charities emergency powers to violate restrictions can paradoxically lead to more rather than less donor control. Some donors understand this risk and already seek techniques to maintain control, such as giving while living and creating sunseting funds rather than donating to endowments so that they can monitor the use of their gifts.<sup>52</sup> The effectiveness of the John M. Olin Foundation, which spurred the law and economics movement and created law and economics programs in prominent law schools across America, provides an example of how large gifts for current spending can lead to major social change.

Finally, in response to the law allowing violations of legal restrictions, donors may increasingly choose not give to charity at all. Indeed, the wealthiest Americans are already using non-charitable vehicles like limited liability corporations for their giving, thus not supporting legal charities and, instead, keeping their assets within their legal control. For example, the Chan Zuckerberg Initiative (CZI), a limited liability corporation with a mission to build a better future, is not legally required to use its assets to advance its purposes of building a better future; it would have been legally required to do so had the founders donated those assets to charity with the same purpose. Moreover, fiduciaries to charities cannot consider the private ends of donors in their decision-making; CZI's fiduciaries, including Mark Zuckerberg, are free to advance the interests of Zuckerberg and Facebook through CZI's activities. If donors do respond in this manner—foregoing charitable giving, and, instead, retaining ownership of their assets—they effectively increase their power to shape society to their own ends rather than to charitable ends in both the short and long run.

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52. See, e.g., JOANNE FLORINO & DAVID BASS, *PROTECTING YOUR LEGACY: A WISE GIVER'S GUIDE TO HONORING AND PRESERVING DONOR INTENT* (Karl Zinsmeister ed., 2020) (advising donors on how to ensure their donations are being used for their intended purpose).



#### D. Intergenerational Economic Equity and Justice

Despite criticism, the traditional justification for endowments—intergenerational equity—remains a compelling. Over thirty years ago, Henry Hansmann argued that endowments were inefficient and intergenerationally inequitable because of economic growth—future generations will be increasingly wealthier and less needy<sup>53</sup>—but economic conditions have since called this assumption into question. Recently, Brian Galle claimed that because the life of a charity is not indefinite, an appropriate discount rate will mandate spending more than is usually spent during the current period.<sup>54</sup> Although Galle is right that an individual charity, that is the entity, will not likely last forever, the charitable purposes to which an endowment of that entity must be devoted can be, and often are, perpetual. Purposes transcend generations. Education? Health? Art? Music? Religion? These broad purposes have lasted throughout human history.

There are moral as well as economic arguments for serving future generations. Intergenerational equity requires leaving future generations the material with which to build their societies. Moreover, transfers of charitable assets among generations for the purpose of the public good do not raise the same concerns as wealth transfers within families, which tend to privilege only a small number of individuals. As Rob Reich explains, although the same array of organizations need not exist across generations, each generation will require the associational and social infrastructure to build social capital.<sup>55</sup> The organizational infrastructure of charities such as universities and hospitals may well be a significant component for building future social capital, and without endowments, such infrastructure does not easily exist.<sup>56</sup>

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53. Henry Hansmann, *Why Do Universities Have Endowments?*, 19 J. LEGAL STUD. 3 (1990); Burton A. Weisbrod & Evelyn D. Asch, *Endowment for a Rainy Day*, STAN. SOC. INNOVATION REV. ONLINE (2010), [https://ssir.org/articles/entry/endowment\\_for\\_a\\_rainy\\_day](https://ssir.org/articles/entry/endowment_for_a_rainy_day) [<https://perma.cc/ZC7P-6ZE7>].

54. Brian Galle, *Pay It Forward? Law and the Problem of Restricted-Spending Philanthropy*, 93 WASH. U. L. REV. 1143 (2016). In part, Galle was critiquing Mike Klausner's defense of an infinite payout term. See Michael Klausner, *When Time Isn't Money: Foundation Payouts and the Time Value of Money*, 1 STAN. SOC. INNOVATION 51 (2003) (arguing that because the relevant lifetime of a charity is indefinite, charities ought to spend using a standard model of capital budgeting where firms spend to obtain an equal marginal return in each period).

55. ROB REICH, JUST GIVING: WHY PHILANTHROPY IS FAILING DEMOCRACY AND HOW IT CAN DO BETTER 181 (2019).

56. Why is the state unable to serve this function by putting aside funds for the next generation? Perhaps because the incentives for current spending are strongest for politicians who must please voters today, making it difficult to build social capital for the future. Reich offers two

Universities provide an excellent example of infrastructure beyond a single generation's ability to create. The University of Bologna—founded in 1088 and the oldest university in the western world—has provided a home for scholars and students over centuries. Its history of countering for-profit markets, the government,<sup>57</sup> and the church provides important lessons in the need for independent entities to have independent resources over the very long term.<sup>58</sup>

### CONCLUSION

The arguments for maintaining the current legal structure should not be overstated. Some crises are existential. Indeed, scholars have argued that urgent and decisive action on climate change requires a tiny discount rate<sup>59</sup>—suggesting that we should spend now or risk extinction. There may well be crises requiring the use of all assets and which makes adhering to restrictions to protect the future moot, such as world-ending climate change or nuclear war; but for all the deep pain and havoc that the COVID-19 pandemic continues to work, unprecedented pandemics and other devastating crises are a reality of human life that does not truly threaten the end of the world.

On reflection, the law is wise to require fidelity to restrictions, even endowment restrictions. As the first part of this essay explains, the law is not so cruel as to make charities and the people they serve long for the money in the bank or require them to dedicate funds to outmoded purposes or methods. Instead, it provides safety valves during trying times in the form of cy pres and deviation. It merely does not permit charities to decide for themselves, without oversight, when to change the purpose or release restrictions. Even in a crisis.

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reasons why foundations rather than government should provide for the future: the importance of independence of associational life from the government, “as a ‘buffer’ or a countervailing force to state power,” and pluralism, which the charitable sector can produce and a majoritarian government cannot, at least easily, promote. *Id.* at 181–183.

57. Although the university is technically public, it is quite similar in terms of its operations to a U.S. charitable university. Since its earliest days when it was instrumental in ending collective punishment by cities on foreigners, it has served as a counterbalance to government. For a brief overview see University of Bologna, WIKIPEDIA, [https://en.wikipedia.org/wiki/University\\_of\\_Bologna](https://en.wikipedia.org/wiki/University_of_Bologna) [<https://perma.cc/D32M-XMYR>].

58. I thank Steve Poskanzer for raising this argument.

59. See NICHOLAS STERN, STERN REVIEW: THE ECONOMICS OF CLIMATE CHANGE 60 (2006).