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New Chapter in the New York Law of Charitable Corporations

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A NEW CHAPTER IN THE NEW YORK LAW OF CHARITABLE CORPORATIONS[1]

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As the result of a recent decision of the New York Court of Appeals in *St. Joseph's Hospital v. Bennett*,[2] charitable corporations find new uncertainties in the law governing the administration of their funds. Such corporations perform important educational, religious and eleemosynary services, and in the interest of a sound continuance of these services it is desirable that the uncertainties should be adequately resolved. In anticipation of a possible legislative clarification of the law, it seems expedient to review the decision and the perplexing questions that stem from it. The decision itself is clear, both as to the facts and the holding.

The suit was for a declaratory judgment. The hospital asked the court to declare that a bequest of money which, by the terms of the will, was "to be held as an endowment fund and the income used for the ordinary expenses of maintenance" was not a trust fund but an absolute gift to the hospital which it might use to discharge a first mortgage on the hospital property. The Supreme Court granted the petition[3] and the Appellate Division affirmed the judgment.[4] On appeal by the Attorney General to the Court of Appeals, the judgment below was reversed.[5] The Court of Appeals held that the testator's words quoted above clearly evidenced his intention that the gift should be held as a permanent or "endowment" fund, that only the income of the fund should be used for hospital purposes, and that this was an enforceable condition of the gift.

While charitable corporations generally have carried out in good faith the conditions imposed by donors, it has been thought that under New York law a donor's words of restriction or direction as to use were precatory only and did not impose an obligation enforceable against the corporation.[6] The prevailing opinion of the Appellate Division in the hospital case clearly expressed this view.

"The words of intention are clear, but do not impose a legal obligation. . . . We are not dealing, however, with what ought to be done, but with

[1]Charitable corporations as used here and as commonly understood in New York law include not only corporations limited to eleemosynary purposes but also those organized for religious and educational purposes.
[2]281 N. Y. 115, 22 N. E. (2d) 305 (1939).
[3]Special Term, Onondaga County.
[4]256 App. Div. 120, 8 N. Y. S. (2d) 922 (4th Dep't 1939).
[5]*See* note 2, *supra*.
[6]Wetmore v. Parker, 52 N. Y. 450 (1873); Corporation of the Chamber of Commerce of N. Y. v. Bennett, 143 Misc. 513, 257 N. Y. Supp. 2 (Sup. Ct. 1932); (1939) 23 MINN. L. REV. 670; (1939) 53 HARV. L. REV. 327.

what must be done. As long as the corporation uses the funds which are its property absolutely for its corporate purposes, neither the donor's representatives nor the State may intervene to require a strict compliance with the donor's expressed intentions."[7]

Justice Lewis, dissenting in the Appellate Division, had a different opinion.[8]

"Whether we are to regard the respondent's duty, upon accepting a bequest thus burdened, as fiduciary in character or as impressed with a duty which bears some other legal label, I am not in accord with a ruling which construes as futile the clear language deliberately employed by the testator to define the use he intended for his gift."[9]

The Court of Appeals, reversing the Appellate Division, held[10] that the gift did not create a trust in the strict legal sense, because "trustee and beneficiary are one," but that it was a gift for a directed purpose to which the corporation must adhere unless and until the court, applying the *cy pres* doctrine, should permit its use for another purpose. The Court of Appeals was not unanimous. Judge Hubbs wrote a dissenting opinion, Chief Judge Crane concurring, in which the view was expressed, derived from examining a long line of New York cases,[11] that the gift to the hospital was absolute and therefore the testator's direction that the gift be used for a specified purpose amounted only to a request which did not, in law, limit the corporation's use of the fund.

The prevailing and dissenting opinions in the two courts reveal most interestingly the confusion in the cases prior to the decision. Undoubtedly the decision clarifies the New York rule on the single issue litigated. Probably it changes the rule. Judge Hubbs and Judge Sears seem to believe that it does.[12] But there are related questions that remain unanswered, and because of this decision[13] these questions are occasioning new perplexities for the trustees of charitable corporations in New York and elsewhere.

These questions include the following which are discussed in this article.

I. Are gifts to charitable corporations for specified purposes to be classified as true trusts, implied trusts or *quasi* trusts, or are they merely restricted

[7]256 App. Div. 120, 121, 8 N. Y. S. (2d) 922 (4th Dep't 1939).

[8]It is interesting to note that Justices Sears and Lewis, who respectively wrote the prevailing and dissenting opinions in the Appellate Division, are now judges of the Court of Appeals.

[9]256 App. Div. 120, 124, 8 N. Y. S. (2d) 922 (4th Dep't 1939).

[10]281 N. Y. 115, 123, 22 N. E. (2d) 305 (1939).

[11]Sherman v. Richmond Hose Co., 230 N. Y. 462, 130 N. E. 613 (1921); Bird v. Merklee, 144 N. Y. 544, 39 N. E. 645 (1895); Wetmore v. Parker, 52 N. Y. 450 (1873); Brayton v. Rector of Christ Church, 249 App. Div. 290, 292 N. Y. Supp. 131 (4th Dep't 1936); Corp. of Chamber of Commerce v. Bennett, 143 Misc. 513, 257 N. Y. Supp. 2 (Sup. Ct. 1932).

[12]281 N. Y. 115, 128, 22 N. E. (2d) 305, 256 App. Div. 120, 122, 8 N. Y. S. (2d) 922 (4th Dep't 1939).

[13]281 N. Y. 115, 22 N. E. (2d) 305 (1939).

gifts that create an obligation, *sui generis,* enforceable against the donee corporation? Does the language of the gift determine or affect such classification?

II. Are gifts for "endowment" to be classified as trusts or restricted gifts or are they unrestricted? What are the enforceable obligations, if any, as to the donee's use of the corpus of gifts for endowment?

III. May charitable corporations commingle or pool, for investment with their other funds, the corpus of gifts for specified purposes?

IV. Does the enforceable obligation, which the Court of Appeals recognized in the *St. Joseph's Hospital* case, impose an obligation to meet ordinary trust standards in the investment of the *corpus* of such gifts?

V. How will the obligations of charitable corporations with respect to their restricted gifts be enforced?

I

Prior to 1893 an uncertain and shifting public policy as to charitable trusts and uses was largely responsible for confusion in the New York law. The English statute of charitable trusts and uses, known as the Statute of Elizabeth,[14] had been law in the colony of New York but the new state in a spirit of revolutionary fervor repealed all acts of the British Parliament, including that statute.[15] A hundred years of litigation and uncertainty reached a climax when the will of Hon. Samuel J. Tilden came before the courts for construction.[16] Mr. Tilden had been a distinguished member of the New York bar and his will gave evidence of careful drafting. Nonetheless his charitable dispositions, for the founding of a free public library in New York City, were frustrated because the New York law recognized as valid only those charitable trusts of which the beneficiaries were immediately ascertainable persons.[17] Those trusts which were for indefinite beneficiaries would not be enforced. Public opinion was aroused and in 1893 a statute of charitable trusts and uses, commonly called the Tilden Act, was enacted.[18] This statute substantially reintroduced into New York law the English statute which had prevailed in colonial New York.

The effects of the earlier confusion are still found in New York law, notably in the cases construing gifts to charitable corporations. In order to uphold

[14]43 Eliz. c. 4 (1601).

[15]L. 1788, c. 46, § 37. Williams v. Williams, 8 N. Y. 525 (1853) held that the English law of charitable uses became the law of this state, but after a series of decisions culminating with that in Holmes v. Mead, 52 N. Y. 332 (1873), the opposite view prevailed.

[16]Tilden v. Greene, 54 Hun 231, 7 N. Y. Supp. 382 (1st Dep't 1889).

[17]Tilden v. Green (sic), 130 N. Y. 29, 28 N. E. 880 (1891). Saxe, Our New York System of Charities, The Cy Pres Doctrine. Reprinted from the New York State Bar Association Bulletin of June, 1937.

[18]L. 1893, c. 701, §§ 1, 2; PERSONAL PROPERTY LAW § 12; REAL PROPERTY LAW § 113.

the donor's or testator's charitable intentions as far as it was reasonably possible to do so, the courts frequently construed gifts to charitable corporations as outright gifts even when the terms of gift contained express trust language or other words importing a charitable use.[19]

It was recognized that such gifts were not "true trusts" because of the identity of trustee and beneficiary. When the estate of the trustee and that of the beneficiary merge in one entity, the trust is extinguished and the trustee-beneficiary takes the entire estate.[20] However, if gifts to a charitable corporation that were expressed to be in trust or for specified purposes actually did not partake of the nature of a trust or use, then the doctrine of *cy pres* would be inapplicable and many gifts for charity would necessarily fail of accomplishing the benevolent purposes which their donors contemplated.

Cy pres is the principle by which, if the original objects of a charitable trust or use can no longer be fulfilled, the courts will carry out a donor's "general charitable intent," if clearly expressed, by applying the gift to some parallel or related charitable purpose. *Cy pres* was incorporated into the statute law of England by the Statute of Elizabeth,[21] which was early abrogated in New York[22] and not fully reintroduced until 1893 when the Tilden Act was enacted.[23] It has been held that courts will not use their *cy pres* powers with respect to outright gifts, but only where the gift, grant, devise or bequest is for a religious, educational, charitable or benevolent trust or "use."[24]

Having held that restricted gifts to charitable corporations, even when expressed as trusts, were not trusts but outright gifts and having refused to apply the *cy pres* principle to outright gifts, there was an embarrassing problem when cases came before the courts which called for application of the *cy pres* principle in order that the donor's charitable intention might be continued after the original donee had ceased to exist or where for some other reason it had become impossible for the original donee to execute the donor's charitable intent. In 1921 the Court of Appeals, in *Sherman v.*

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[19]St. John v. Andrews Institute, 191 N. Y. 254, 83 N. E. 981 (1908); Robb v. Washington and Jefferson College, 185 N. Y. 485, 78 N. E. 359 (1906); Tabernacle Baptist Church v. Fifth Avenue Baptist Church, 60 App. Div. 327, *aff'd,* 172 N. Y. 598, 64 N. E. 1126 (1902). *Cf.* Art Students' League v. Hinkley, 31 F. (2d) 469, 479 (D. Md. 1929), *aff'd,* 37 F. (2d) 225 (C. C. A. 4th 1930), *cert. denied,* 281 U. S. 733 (1930). *Cf. also* Dwyer v. Leonard, 100 Conn. 513, 124 Atl. 28 (1924).

[20]Sherman v. Richmond Hose Co., 230 N. Y. 462, 130 N. E. 613 (1921); Swisher v. Swisher, 157 Iowa 55, 62, 137 N. W. 1076 (1912). *Cf.* Curtis & Barker v. Central University, 188 Iowa 300, 320, 176 N. W. 330 (1920).

[21]43 Eliz. c. 4 (1601).

[22]L. 1788, c. 46, § 37.

[23]L. 1893, c. 701, §§ 1, 2; PERSONAL PROPERTY LAW § 12; REAL PROPERTY LAW § 113.

[24]Fralick v. Lyford, 107 App. Div. 543 (3d Dep't), *aff'd,* 187 N. Y. 524, 79 N. E. 1105 (1907).

Richmond Hose Co.,[25] squarely met this issue and held that, while the trust was not an ordinary trust created by a donor, it was nevertheless a trust created by the charter of the charitable corporation and *cy pres* could be applied as to a charitable trust. In the *Sherman* case the bequest contained no trust language but the will of the testatrix specified that the fund should be held by the corporation and the income used for its corporate charitable purposes. The Court of Appeals said:[26]

> "This gift created no trust. . . .
>
> "The doctrine of charitable uses involving the idea of a trust and indefinite beneficiaries did not become part of the law of New York. [citing cases]. We thought it better to limit a charitable gift in perpetuity to those instances where it was made absolutely to a corporation whose objects were approved by the legislature and which was authorized to accept it under such conditions as the legislature might impose. [citing cases]. Yet the kind of uses called charitable are of assistance in deciding what is a charitable purpose. . . .
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> "Holding as we do that this was a bequest for a charitable purpose to a corporation authorized by its charter to receive bequests for that purpose the answer to this problem is clear. . . . It held the property in trust—not a trust imposed by the donor but by the charter which required the corporation to perpetually devote its funds to such purposes. [citing cases]. To hold otherwise would be to permit the destruction of the greater part of the charitable bequests made in this state during the last century."

According to the ancient definition a "use" was a beneficial interest which limited the holder of the legal title in his enjoyment of the property. It has been said that there is no more all-embracing term for any estate which is less than legal.[27] The holder of the "use" was called the *cestui que use*.[28] This concept of a "use" prevailed when the Statute of Elizabeth[29] was enacted. After the enactment of the Tilden Act in New York,[30] the courts held that it had restored in this state the English law of charitable uses effective at the time of the Revolution.[31]

The *Sherman* case[32] appears to be the first clear indication in New York that courts will find a "use" within the meaning of the Tilden Act even where, as in the case of charitable corporations, the legal and equitable

[25] 230 N. Y. 462, 130 N. E. 613 (1921). *Cf.* Matter of Merritt, 280 N. Y. 391, 21 N. E. (2d) 365 (1939).
[26] 230 N. Y. 462, 467-468, 472, 130 N. E. 613 (1921).
[27] Matter of Scharmann, 63 Misc. 640, 642, 118 N. Y. Supp. 687 (Surr. Ct. 1909).
[28] 11 C. J. 225.
[29] 43 Eliz. c. 4 (1601).
[30] 1893 (*See* note 23, *supra*).
[31] Allen v. Stevens, 161 N. Y. 122, 55 N. E. 568 (1899).
[32] 230 N. Y. 462, 130 N. E. 613 (1921).

titles have merged.[33] To like effect is *Matter of Walter,*[34] in which Surrogate Foley states:[35]

> "It is argued by counsel for the next of kin that the *cy pres* rule may not be invoked for the reason that the bequest to the hospital was absolute and not a gift in trust. This contention has no merit. Under the provisions of section 12 of the Personal Property Law and the pertinent authorities, a gift to a charitable organization, although in outright terms, is, nevertheless, a gift in trust for the general purposes of the institution as defined by its certificate of incorporation. If it is reasonably certain that the testator intended that the bequest be devoted to purposes of charity, even where there is no formal trust, a 'gift in trust will be implied'."

Surrogate Foley cited as authority *Matter of Durbrow*[36] and the *Sherman* case.[37]

In our day charities, including in that term eleemosynary, educational and religious objects, are administered almost exclusively by corporations. Gifts to such corporations for one or more of their corporate purposes, even where trust language is used in the terms of gift, are not true trusts because of the merger of the legal and equitable estates.[38] This condition has resulted through judicial decisions in a new definition of charitable trusts and uses, a definition which differs from the concept of trusts and uses commonly accepted in England when the Statute of Elizabeth was enacted.[39]

Mr. Justice Andrews in the *Sherman* case[40] frankly accepted as a "charitable use" the charitable purposes established by the corporate charter and held the gift to be a trust established, not by the donor, but by the provisions of the corporate charter. Surrogate Foley in *Matter of Walter*[41] arrived at substantially the same result, holding that there was an implied trust but no formal trust. The Supreme Court of Rhode Island in a recent case designated this legal relationship as a *quasi* trust.[42] Now, in the *St. Joseph's Hospital* case,[43] the New York Court of Appeals seems frankly to have abandoned the theory that there is a trust, actual or implied, but does hold that the gift to the corporation for specified purposes created an "obligation" which is enforceable by the Attorney General against the donee cor-

[33]St. Joseph's Hospital v. Bennett, 281 N. Y. 115, 123, 22 N. E. (2d) 305 (1939).
[34]150 Misc. 512, 269 N. Y. Supp. 402 (Surr. Ct. 1934).
[35]*Id.* at 514.
[36]245 N. Y. 469, 157 N. E. 747 (1927).
[37]230 N. Y. 462, 130 N. E. 613 (1921).
[38]*See* notes 19 and 20, *supra.*
[39]1601.
[40]230 N. Y. 462, 130 N. E. 613 (1921).
[41]150 Misc. 512, 269 N. Y. Supp. 402 (Surr. Ct. 1934).
[42]Pennsylvania Company For Insurances On Lives And Granting Annuities v. Contributors to Pennsylvania Hospital, *et al.*, 9 A. (2d) 269 (Sup. Ct., R. I., November, 1939).
[43]281 N. Y. 115, 22 N. E. (2d) 305 (1939).

poration and to which the courts can apply the *cy pres* principle. The court did not classify this obligation. Possibly it has some elements of a contractual obligation, but it seems more likely that restricted gifts to charitable corporations in New York are henceforth to be recognized as creating a fiduciary relationship which is *sui generis*.

It is noteworthy that in all three of these New York cases[44] words of trust were lacking in the terms of gift. In all three, however, the donors had stated the purpose for which the gifts were to be used.

There is a conflict of authority as to whether a true trust is created by a gift to a charitable corporation for one of its charter purposes when expressed in trust language. The *Restatement of Trusts*[45] declares that no trust is thus created. The writer of a recent law review article[46] takes the opposite view and after a survey of the decisions in many states concludes that Professor Bogert (who was one of the draftsmen of the *Restatement*) is correct when he says:[47]

> "Occasionally it becomes important to learn whether a donor intended to make an absolute gift to a charitable corporation to be used by it for one or more of its corporate purposes, or desired to make the charitable corporation trustee of a charitable trust. It is clear that there is a distinction in these two intents and the legal results of their expression."

Nevertheless, as has been noted above, the New York courts have held that no trust is created even when the gift is expressed in trust language.[48]

The *St. Joseph's Hospital* case was decided by the Court of Appeals on July 11, 1939. On October 16, 1939 the Carnegie Foundation for the Advancement of Teaching (a corporation) instituted a proceeding in the Supreme Court, New York County, for permission to enter into a teachers' pension refinancing plan and to use *cy pres* a part of its endowment for annuity payments free from any restriction or limitation contained in the terms of Mr. Andrew Carnegie's gift. The Attorney General consented to the plan and the appropriate order *cy pres* was entered.[49] The decision has not been reported. This is interesting because it is an application, subsequent to the *St. Joseph's Hospital* decision, of the *cy pres* doctrine to the endowment of a charitable corporation.

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[44]St. Joseph's Hospital v. Bennett, 281 N. Y. 115, 22 N. E. (2d) 305 (1939); Sherman v. Richmond Hose Co., 230 N. Y. 462, 130 N. E. 613 (1921); Matter of Walter, 150 Misc. 512, 269 N. Y. Supp. 402 (Surr. Ct. 1934).

[45]2 RESTATEMENT, TRUSTS (1935) c. 11, p. 1093.

[46]Lincoln, *Gifts to Charitable Corporations* (1939) 25 VA. L. REV. 764.

[47]2 BOGERT, TRUSTS AND TRUSTEES (1935) § 324, p. 1031.

[48]St. John v. Andrews Institute, 191 N. Y. 254, 83 N. E. 981 (1908).

[49]Presumably the order was granted pursuant to the broad equity powers given to the Supreme Court by Sec. 12, Personal Property Law (L. 1893), referred to in the petition.

II

Endowment is commonly understood as a fund yielding income for the support of an institution.[50] The early cases construing endowments are found chiefly in tax litigation. Some states had a policy of exempting from taxation (1) the real property of a charitable corporation used for its charitable purposes, and (2) the endowment of the charitable corporation. It has been held that endowment does not include real estate, even when purchased with endowment funds.[51]

During the recent years of acute financial distress for small institutions, the question has been raised occasionally as to whether endowment partakes of the nature of a trust so that the *cy pres* principle is applicable, or is the outright property of the corporation which its creditors may reach. It has been held that the courts may apply *cy pres* to the endowment funds of a college and that the funds given for endowment of the institution are not available in satisfaction of the claims of its creditors.[52]

Where the endowment fund was created by action of the corporation, as in *Hobbs v. Board of Education*,[53] it is suggested that possibly there is no restriction on the fund and creditors may be paid from it. While the Nebraska court held that the endowment in the *Hobbs* case was not a trust to which the court could apply the *cy pres* doctrine, it nevertheless proceeded to transfer the fund to another charitable corporation under the "conceded judicial powers of the court."[54]

The action of a board of trustees in setting aside unrestricted funds as an endowment might create certain contractual or *quasi* trust obligations where donors relied upon that action in making subsequent gifts. This apparently is not considered in the cases. However, it seems likely that the New York courts might find in such action an enforceable obligation, binding on the institution, to keep the endowment intact and expend the income only. An illustration of this situation is found in an Associated Press dispatch from Baltimore under date of November 6, 1939. As printed in the *New York Times* the dispatch read as follows:[54a]

> "The Johns Hopkins University will match a $500,000 grant from the Rockefeller Foundation and create a $1,000,000 endowment for the

[50]20 C. J. 1255.
[51]State, First Reformed Dutch Church, pros. v. Lyon, 32 N. J. L. 360, (1867); State v. Krollman, 38 N. J. L. 323 (1876).
[52]Graham Bros. Co. v. Galloway Woman's College, 190 Ark. 692, 81 S. W. (2d) 837 (1935); Starr v. Morningside College, 186 Iowa 790, 173 N. W. 231 (1919); Lupton v. Leander Clark College, 194 Iowa 1008, 187 N. W. 496 (1922). *Cf.* Hobbs v. Board of Education, 126 Neb. 416, 253 N. W. 627 (1934).
[53]126 Neb. 416, 253 N. W. 627 (1934).
[54]*Id.* at 440.
[54a]November 7, 1939, p. 27, col. 1.

biological sciences. The Rockefeller grant was contingent on the university providing an equal endowment. The university's matching fund will be taken from the bequest of Louis J. Boury of New York, who died in 1937 and left the residue of his estate to Johns Hopkins."

While the dispatch is not precise as to the facts, it may be that the University's contribution to endowment was a transfer from its unrestricted funds and in that event the entire fund would appear to be set apart as a permanent endowment (if construed under the New York rule) subject to an obligation to preserve the principal and use the income only for work in the biological sciences.

It appears in the *Hobbs* case that the Board of Trustees of Grand Island College had invested a part of its endowment fund in a student dormitory and when the college subsequently got into financial straits the Board claimed that a like sum should be set aside from the general assets to reimburse the endowment. The court said, as to that item:

"Claim of Grand Island College to reimburse the endowment fund the sum of $26,726.41 which it withdrew from said fund many years ago with which to build a girls' dormitory. This cannot be allowed. When these funds were withdrawn they were converted into property which cannot be separated from the general assets of the college to the prejudice of creditors. The same is true of quite a number of other misapplications of the fund. If there is any remedy for these acts it lies with the successor in trust or the donors against the college trustees."[55]

In view of the cases it seems clear that funds given for endowment should be treated as restricted gifts, if not as trusts, and that the principal of endowments should be preserved for the purpose of producing revenue. Indeed, in *Associate Alumni v. Theological Seminary*[56] a gift to the defendant as endowment for the establishment of a professorship was held to be a gift in trust in which the donors retained sufficient interest to enable them to enjoin upon the defendant specific performance of the terms and conditions even though there was no right of reverter attached to the original gift.

It is not clear whether endowment funds can properly be invested in the college's own real estate. Institutions other than Grand Island College[57] have sometimes invested their endowment funds in college buildings. Certain standards should be met whenever any such investment is made, to safeguard the endowment principal, and these basic requirements include the following: (1) Investment should be only in income-yielding property, which is (2) so constructed as to pay a net income yielding a fair return at least

[55]126 Neb. 416, 437, 253 N. W. 627 (1934).
[56]26 App. Div. 144 (1st Dep't), *mod.*, 163 N. Y. 417, 57 N. E. 626 (1900).
[57]Hobbs v. Board of Education, 126 Neb. 416, 253 N. W. 627 (1934).

equal to the yield from endowment fund securities (3) after making annual provision for depreciation and amortization sufficient to return the principal sum to the fund.

III

The practice of commingling or pooling funds for investment is common among institutions, but no cases have been found which expressly permit it and only three that seem to prohibit it.[58]

Where the terms of a gift to a charitable corporation contained language expressly stating the donor's intention that the fund should be held "in trust," some institutions have invested the fund separately. There seems to be no uniformity of practice even as to the so-called trust funds except in cases where the terms of gift expressly require segregated investment. Where a gift is expressed not as a trust but for "endowment," or is a gift the income of which is to be used by the donor's direction for specified charter purposes of the donee corporation, many institutions, in order to simplify their investment problems, have adopted the expedient of pooling all such gifts with their unrestricted funds, investing them together as a pooled fund. The separate funds are entered on the books at their initial inventory values. When the average rate of income on the investments in the pooled fund is computed, this rate is assigned to the principal of each of the book funds and the income thus computed is expended for the designated uses of the several restricted funds. Capital gains usually accrue only to the unrestricted funds, which likewise absorb losses.[59]

This practice of pooling funds for investment seemed fair enough and legally permissible so long as the New York rule was, or was thought to be, that the corporation was the absolute owner of its funds free of any enforceable obligation of strict compliance with the expressed intention of the donor. Now that the Court of Appeals has laid down the rule that the corporation can be made to use each fund for the purpose designated by its donor, the practice of pooling requires reexamination. It may be debatable whether as a matter of law the obligation to use the income of a particular fund for a specified purpose, which obligation the donee corporation accepted as a condition of the gift, is satisfied by expending for the directed use a sum equivalent to interest on the principal sum of the gift computed at the average rate of income on the corporation's pooled funds.

[58]Moore v. McKenzie, 112 Me. 356, 92 Atl. 296 (1914); Attorney General v. City of Lowell, 246 Mass. 312, 141 N. E. 45 (1923); Fosdick v. Town of Hempstead, 125 N. Y. 581, 26 N. E. 801 (1891).

[59]E. S. Erwin (Assistant Comptroller Stanford University) "The Policy of Merged Investments and their Legal Aspects" read before Ass'n. of Business Officers of Universities and Colleges, at Chicago, May, 1937. Blackwell, *The Charitable Corporation and the Charitable Trust* (1938) 24 WASH. U. L. Q. 1.

It has long been accepted as the rule that a trustee may not, without express permission given in the instrument creating the trust, mingle the funds of one trust with the funds of other trusts or with his own property.[60] In the *Restatement of Trusts* there is the following summary of the rule:

> "The trustees of a charitable trust, like the trustees of a private trust, are subject to duties to administer the trust . . . to keep the trust property separate from their individual property. . . ."[61]

The rule against mingling private trust funds may be relaxed somewhat. The *Restatement* concedes that where "it would be unreasonable and not subserve any purpose in protecting the interests of the beneficiaries of the several trusts to require him to keep separate the funds of the different trusts, it may be proper for the trustee to mingle funds of the different trusts by deposit thereof in a common bank account."[62]

Professor Bogert is authority for the following statement:

> "It is also a breach of trust of this type if the trustee commingles two distinct trust funds. . . . There has been some tendency, however, to permit the mingling of two or more trust funds in an investment, provided the trustee keeps accurate books with regard to the shares of each trust, and each cestui is given notice of his exact interest."[63]

Several cases are cited by the text writers as authority for this relaxation of the strict rule that prohibits the mingling of private trusts.[64] While there have been found no cases that distinguish between a charitable trustee and a private trustee, as to their right to commingle trust funds, neither one is precisely analogous to the board of trustees of a charitable corporation. It has been held that such boards are not subject to all the restrictions and regulations usually imposed on trustees; indeed, both prevailing and dissenting opinions in the *St. Joseph's Hospital* case agreed that the charitable corporation was not bound by all the rules applicable to a technical trustee.[65] However, none of the cases had to do expressly with the question of mingling funds.

The Supreme Judicial Court of Maine in *Moore v. McKenzie*[66] criticizes mingling. The trustees of a charitable trust were directed to maintain a hospital. The following question was certified to the court:

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[60] 2 RESTATEMENT, TRUSTS (1935) § 379, p. 1173.
[61] *See* note 60, *supra*.
[62] 1 RESTATEMENT, TRUSTS (1935) § 179, p. 457.
[63] 3 BOGERT, TRUSTS AND TRUSTEES (1935) § 596, p. 1888.
[64] Matter of Kohler, 231 N. Y. 353, 132 N. E. 114 (1921); Gould v. Gould, 126 Misc. 54, 213 N. Y. Supp. 286 (Sup. Ct. 1925); Matter of Watson, 81 Misc. 89, 142 N. Y. Supp. 1058 (Surr. Ct. 1913); Jones v. Harsha, 233 Mich. 499, 206 N. W. 979 (1926).
[65] St. Joseph's Hospital v. Bennett, 281 N. Y. 115, 123, 125, 22 N. E. (2d) 305 (1939).
[66] 112 Me. 356, 92 Atl. 296 (1914).

"(5) Can the trust fund of $15,000 for the benefit of Stella R. McKenzie and the trust fund for the benefit of the Webber Hospital Association be invested together and the net income be paid to each pro rata, or shall there be two distinct funds set apart?"

The court said:

"We know of no authority of law for the mingling of trust funds proposed by this inquiry. Not for a moment could it be considered if the two trusts were to be administered by distinct trustees. That the trustees were or are the same, or that the corpus of each fund finally is to be paid to the same person can make no difference. Each trust must stand alone, otherwise losses legitimately to be borne, with corresponding loss of income by one, could be imposed in part upon the other."

It is possible, although not decided, that the mingling of trust funds proposed by the certified question might have been permitted if both trusts had been exclusively for charitable purposes. The use of one of the trust funds was to an individual for life, with the remainder over to the charitable use. The court does not discuss this distinguishing feature but states that it makes no difference in the result that the corpus of the fund finally is to be paid to the same person.[67] Of some significance, in view of the *St. Joseph's Hospital* case, is the reason the Maine court assigned for its holding that the trusts should not be commingled. Great weight was given to the possibility that income loss which should be borne by one of the trusts might, as the result of commingling, be imposed in part upon the other trust. If the donee is subject to an obligation to use the income of the donor's fund for the uses specified by the donor, then the commingling of the fund with other funds might result in loss of income in that fund, as against its possible income if the fund had been kept separate.

The only case found in which the New York courts have considered this question in relation to a charitable gift is *Fosdick v. Town of Hempstead*,[68] where a bequest was left to the town "to be kept as a fund for the support of the poor of said town, and to be known as 'The Hewlett Fund.'" This was held to be a trust fund which should be kept intact and separate from the other moneys of the town.

In *Attorney General v. City of Lowell*[69] it was held that the impairment in principal of a fund for the poor, which had never been segregated, must be restored and the terms of the gift obeyed by the city. The court said:

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[67] *Id.* at 360.
[68] 125 N. Y. 581, 26 N. E. 801 (1891). (The trust was thereafter held invalid for indefiniteness, but the decision on that point would be *contra* today under the Tilden Act. PERSONAL PROPERTY LAW § 12; REAL PROPERTY LAW § 113).
[69] 246 Mass. 312, 141 N. E. 45 (1923).

"The defendant ought to have kept this bequest separate and apart as a distinct fund."[70]

While these seem to be the only cases which consider directly the question of mingling of funds by charitable institutions (the town and city were considered charitable corporations as to the funds in question), there are many cases in which such mingling in the case of ordinary trusts has been overlooked in equity.[71]

There may be practical taxation reasons in special cases why mingling of funds by a charitable corporation would be undesirable and might be regarded with judicial disfavor. Charitable corporations generally are exempt from federal income and excess profits taxes if no part of their income "inures to the benefit of any private shareholder or individual."[72] Recently the United States Circuit Court of Appeals, Tenth Circuit, held the Scholarship Endowment Foundation subject to income tax notwithstanding that it was an educational corporation, for the reason that it held its endowment subject to an agreement to pay annuities to the donors.[73] The taxpayer has filed a petition with the United States Supreme Court for a writ of *certiorari*, on which that court has not yet acted.[74] There were some special circumstances in connection with the organization of the Scholarship Endowment Foundation which undoubtedly influenced the decision.

Thus, where a charitable corporation receives funds and agrees, at the donor's request, to pay all or part of the income for a period to a "private individual," it seems advisable for the corporation not to commingle the gift with its other funds. Even when the terms of gift permit commingling, present tax uncertainties make it desirable to segregate such gifts.

It has also been suggested that the recent New York statute permitting the pooling of funds by trust companies in common trust funds[75] may furnish an argument that so-called practical mingling has been examined and approved by the legislature. It can as readily be argued, however, that this indicates that a similar enabling statute is necessary if charitable corporations are to enjoy the privilege.

Possibly the mingling of funds as to which a charitable corporation has a contractual or *quasi* trust obligation may be justified by special circumstances. Obviously it tends to average the risks, and the expense of administration is considerably reduced.

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[70]*Id.* at 323.
[71]Matter of Nesmith, 140 N. Y. 609, 35 N. E. 942 (1894); Price v. Holman, 135 N. Y. 124, 32 N. E. 124 (1892); Gould v. Gould, 126 Misc. 54, 213 N. Y. Supp. 286 (Sup. Ct. 1925); *Re* Patrick's Estate, 162 Pa. 175, 29 Atl. 639 (1894); Appeal of Biddle, 129 Pa. 26, 18 Atl. 474 (1889).
[72]INTERNAL REVENUE CODE § 101 (6).
[73]Scholarship Endowment Foundation v. Nicholas, 106 F. (2d) 552 (C. C. A. 10th 1939).
[74]*Certiorari* filed November 20, 1939.
[75]BANKING LAW § 100-c.

Yet in view of the cases it cannot be concluded that the practice of commingling funds will go unchallenged. The decision in the *St. Joseph's Hospital* case leaves the question in doubt, making advisable a review of the different funds held by institutions for restricted uses and for endowment in order to ascertain whether the enforceable obligations attached to the gifts are adequately met when the fund is mingled for investment with other funds of the institution.

IV

If the decision in the *St. Joseph's Hospital* case indicates a trend in New York State toward imposing on the boards of charitable corporations some of the duties of ordinary trustees, it may be advisable to reconsider also the question as to whether such boards are subject to the rule as to investments laid down for trustees in the Personal Property Law.[76] While it is settled[77] that trustees of charitable trusts are held to the same strict rules which govern the investment of private trustees, it does not follow that the boards of charitable corporations are similarly restricted. There seems to be no decision on this point in New York State, and very few elsewhere in this country.

In *Boston v. Curley*[78] the Massachusetts court was asked for instructions as to the proper custody, management and control of two funds held by a corporation for charitable purposes pursuant to instructions in the will of Benjamin Franklin and the highest court had this to say on the subject of investment:

> "Every member of that corporation is charged with the obligations of a trustee and must exercise as to every investment his best judgment and wise discretion. To make investments is fundamental, not merely administrative, in the administration of a trust. To be a manager of the fund involves the performance of personal duty, which as to investments to be made cannot be delegated to a committee or an agent."[79]

A more recent case, decided in 1934, is *Graham Bros. Co. v. Galloway Woman's College*.[80] The gift was subject to reversion if the college should cease to function. That event occurred, and the donor's representatives sought to charge the trustees of the college with personal accountability for loss arising from the investment of the gift. It was held that the board was subject to the same investment rules which govern ordinary trustees in Arkansas, but the court found as a fact that in view of the difficult investment conditions between 1930 and 1934 the board of the college had exer-

[76] Sec. 21.
[77] 2 BOGERT, TRUSTS AND TRUSTEES (1935) § 393.
[78] 276 Mass. 549, 177 N. E. 557 (1931).
[79] *Id.* at 562.
[80] 190 Ark. 692, 81 S. W. (2d) 837 (1935).

cised sound business judgment in investing the endowment fund in the note of the college! The decision is difficult to follow because, while it seems to lay down a broad rule of rigid trustee responsibility, it applies the rule in such a way as practically to open the door for any use of funds by the trustees provided no bad faith is shown.

In *Hobbs v. Board of Education*[81] the question of investing endowment funds in a college dormitory was raised. Without deciding the point, the court referred to this investment as a misapplication of funds.

It is stated by Professor Scott in his work on *Trusts*[82] that the rules applicable to investments by trustees are not necessarily applicable to a charitable corporation as distinguished from a charitable trust, it being a question of interpretation whether statutes applicable to ordinary trustees are likewise applicable to charitable corporations. In *American Law of Charities*[83] the statement is made that charitable trustees cannot invest trust funds in their own business or for their own benefit or accommodation without becoming an insurer of the fund and its productiveness.[84]

The authorities are conflicting and unsatisfactory. It is difficult to know what the rule would be if a case were to arise today. In the *Graham* case[85] there is an obvious inconsistency between the rule laid down by the court and the application of the rule to the facts. It is, however, well known that boards of trustees of charitable corporations have not limited their investments to those permitted by the strict rules governing ordinary trustees and fiduciaries.[86] While the Court of Appeals in the *St. Joseph's Hospital* case stated that charitable corporations are not subject to all the limitations and rules that apply to technical trustees, the effect of the decision is to impose on such corporations certain obligations of a fiduciary nature. It may, therefore, be pertinent to inquire whether one of these fiduciary obligations is that they shall meet ordinary trust standards as to mingling and investment.

V

The *St. Joseph's Hospital* case was an action by the Hospital for a judicial declaration of its rights and obligations with respect to the endowment. It therefore does not decide how the obligation would have been enforced by the courts in the event of a threatened or actual breach. Remedies which the courts have considered, in New York and elsewhere, include suits for specific performance of the terms of gifts, ouster of the corporation in

[81]126 Neb. 416, 253 N. W. 627 (1934).
[82]3 SCOTT, TRUSTS (1939) § 389.
[83]ZOLLMANN, AMERICAN LAW OF CHARITIES (1924) 324.
[84]Bangor v. Beal, 85 Me. 129, 26 Atl. 1112 (1892).
[85]190 Ark. 692, 81 S. W. (2d) 837 (1935).
[86]*See* note 59, *supra*.

quo warranto proceedings and actions to remove the directors or trustees of the corporation.

In the *St. Joseph's Hospital* case[87] the court said that the Attorney General may maintain a suit in equity to compel the corporation to hold the property for the charitable purposes for which it was given, citing the *Restatement of Trusts.*[88]

There appears to be but one New York decision in which the right of a donor to specific performance was litigated and upheld. In *Associate Alumni v. Theological Seminary*[89] the fund in question was collected by the alumni association and transferred to the Seminary for the endowment of a professorship with the right reserved to the alumni, in the event of a vacancy in the chair, to nominate the incumbent. Disputes arose and in consequence the chair was left vacant. The Appellate Division[90] directed the Seminary to surrender the fund and transfer it back to the Associate Alumni. The Court of Appeals modified[91] the judgment below so that, instead of directing a return of the fund to the alumni, the plaintiff was directed to hold the fund in trust and apply it on the terms and conditions specified in the resolutions under which the fund was given to the Seminary and accepted by it. While this gift was made prior to the Tilden Act and therefore could have been valid only as an outright gift, the dispute arose thereafter and the court held that there was a trust which it would enforce at the donor's suit although there was no provision for reverter. As donor and possessor of the right to nominate to the professorship, the Associate Alumni was held to have sufficient standing to maintain the action to enforce the terms of the gift.

In *Mills v. Davison*[92] the New Jersey Court of Errors and Appeals, although divided, held that a conveyance of land for church purposes created a trust and that the donor, as the founder of a charity, had standing in equity to restrain the diversion of the property from the uses for which it had been given. This decision did not rest either on a right of reverter or any specifically reserved right to control the subsequent enjoyment of the property.

Whatever the rule may be in other states, however, it seems that in New York the donor may enforce the terms of his gift if he has a right of reverter or some continuing power of control over the subject of the

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[87]281 N. Y. 115, 119, 22 N. E. (2d) 305 (1939).
[88]2 RESTATEMENT, TRUSTS (1935) c. 11, p. 1093.
[89]26 App. Div. 144, 49 N. Y. Supp. 745 (1st Dep't 1898), *mod.*, 163 N. Y. 417, 57 N. E. 626 (1900).
[90]*Ibid.*
[91]163 N. Y. 417, 57 N. E. 626 (1900).
[92]54 N. J. Eq. 659, 35 Atl. 1072 (1896).

gift, its uses or the persons who administer it. Undoubtedly, as the Court of Appeals has recently said,[93] the Attorney General may maintain such an action.

Enforcement of the terms of gift by suit against the corporation is not always a satisfactory remedy. The court can order specific performance and direct that the corporation restore to the fund any losses which may have been caused by improper administration of the gift,[94] or it may oust the corporation from its charter and apply the gift *cy pres*.[95] The former remedy apparently has never been ordered in New York. It has, of course, the inherent weakness that where the wrong has already been done the corporation frequently has no funds with which to repair the damage. It is the equivalent of locking the barn door after the horse has been stolen. The alternative remedy of ouster is equally futile or more so. Ouster dislodges the beneficiary as well as the trustee and it becomes necessary to transfer the fund, or what is left of it, by the *cy pres* device to another charity which, presumably, is less desirable in the eyes of the donor inasmuch as he did not select it. In the event the ousted corporation holds other funds and as to them has fulfilled all its obligations, there is the further difficulty that such other funds will also be adversely affected.

Can the directors of charitable corporations be held responsible for their acts and omissions? The directors of business corporations have certain duties to the shareholders, and correlative rights lie with the shareholders to remove the directors and hold them accountable for acts outside the scope of their authority. Whether or not the trustees of charitable corporations should be held to the same standards as those imposed on the directors of corporations operated for profit, the enforcement of that accountability may be more difficult where the charitable corporation has neither members, shareholders nor any other internal organization capable of managing its disciplinary affairs. The directors of charitable corporations are public-spirited citizens who serve without remuneration, often at considerable sacrifice, and who rightly are accorded greater consideration and possibly should be held to less rigid standards than those imposed on the directors of corporations operated for profit. In some cases, too, the trustees of a charity are themselves incorporated and self-perpetuating, and therefore incompetent effectively to discipline themselves.[96]

No New York case has been found in which the court has surcharged

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[93]*See* note 87, *supra*.

[94]Attorney-General v. City of Lowell, 246 Mass. 312, 141 N. E. 45 (1923).

[95]People v. Dispensary and Hospital Society of the Women's Institute, 7 Lans. 304 (N. Y. 1873).

[96]*See* UNIVERSITY LAW (1892) c. 378 (since amended). State v. Ausmus, 35 S. W. 1021 (Tenn. 1895).

the directors or trustees of a corporate charity for improper administration of its funds.[97] In the absence of express statutory authority, if they are to be removed from office there must be found some excuse for disregarding the corporate form. The directors of a charitable corporation do not individually hold legal title to the corporate property and are not in the true sense of the word trustees. The act of incorporation may be thought to limit their responsibility to that which they owe to the body corporate.

It was early thought that the trustees of religious corporations could be removed by courts of equity as for breach of trust.[98] In 1854, however, the case of *Robertson v. Bullions*[99] was decided and the earlier decisions disapproved. In the *Robertson* case the court held that it had no jurisdiction to remove the trustees who were said to be merely the managing officers of the corporation. This decision has been cited frequently. As recently as 1923[100] the principle of the *Robertson* case was affirmed on the ground that the court had no power to remove the officers and directors of religious corporations without the sanction of a statute.

By statute New York authorizes actions against corporate officers, directors and trustees and provides that the officers, directors and trustees may be compelled to account, may be held personally liable and may be suspended or removed.[101] By other sections of the same statute these remedies are made inapplicable to religious, municipal and public benefit corporations and to a limited degree also to educational corporations.[102] The right of judicial suspension or removal from office is expressly denied except on final judgment in an action brought by the Attorney General,[103] but the other actions may be brought by the corporation itself, or by a creditor, receiver, trustee in bankruptcy, director, or officer of the corporation.

The fact of incorporation may not protect the trustees from individual responsibility in other states.[104] Indeed, trustees were held responsible in

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[97]*Cf.* Boston v. Curley, 276 Mass. 549, 177 N. E. 557 (1931).

[98]Kniskern v. The Lutheran Churches, *etc.*, 1 Sandf. Ch. 439 (N. Y. 1844). *See* Lawyer v. Cipperly, 7 Paige 281 (N. Y. 1838). *Cf.* Bowden v. M'Leod, 1 Edw. Ch. 588, 591 (N. Y. 1833).

[99]11 N. Y. 243 (1854).

[100]Fiske v. Beaty, 206 App. Div. 349, 201 N. Y. Supp. 441 (3d Dep't 1923). The court said, at p. 361, "Certainly this court, without the sanction of a statute, has not the power to shorten their terms by removing them from office. Not only has no such sanction been given but the power of removal has been expressly denied to it."

[101]General Corporation Law §§ 60, 61.

[102]General Corporation Law § 130. This section states, as to educational corporations, that Sections 60 and 61 shall not apply ". . . to any corporation which the regents of the university have power to dissolve, except in aid of its liquidation under such dissolution, upon the application of the regents, or of the trustees of such a corporation." In this connection *see* Education Law § 63.

[103]General Corporation Law § 136.

[104]Boston v. Curley, 276 Mass. 549, 177 N. E. 557 (1931); Nelson v. Cushing, 2 Cush. 519 (Mass. 1848); State v. Ausmus, 35 S. W. 1021 (Tenn. 1895).

early cases in this state.[105] The statutory remedies referred to above,[106] read in conjunction with the new definition of fiduciary obligation of charitable corporations as stated in the *St. Joseph's Hospital* case, may result in a stricter interpretation of the accountability of trustees of charitable corporations in New York.

It is evident that many of these questions, raised by the decision in the *St. Joseph's Hospital* case, can not be satisfactorily answered now. Restricted gifts to charitable corporations are certainly not true trusts, yet the court attributes to them a fiduciary character. It serves no useful purpose for the courts to establish in varying situations an implied trust or a *quasi* trust. At last, after a long course of confused development of the New York law as to charitable trusts and gifts to charitable corporations, the courts have penetrated the legal maze and seem to have evolved a sensible doctrine of a fiduciary obligation, *sui generis*. This is an important milestone in the law of the subject, especially in a society where the charitable corporation has almost entirely supplanted the individual charitable trustee.

Now it remains for the courts or the legislature to resolve the related problems. How many of the trust rules and limitations are applicable to this fiduciary relationship and how far the enforceable obligations extend to the unrestricted as well as the restricted funds of charitable corporations, are questions still unsettled. To avoid further confusion and protracted uncertainty, and to furnish the sound background that will encourage the essential benefactions of donors to eleemosynary, religious and educational corporations, some immediate clarification of public policy through legislative enactment is eminently desirable. In particular, the trustees of charitable corporations should be informed as to the limits of the law applicable to their investment policies, and donors are entitled to know what remedies, if any, are available to them for enforcement of the terms of their gifts.

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[105] *See* note 98, *supra*.
[106] GENERAL CORPORATION LAW §§ 60, 61.