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On the Attorney General's Role Involving Charitable Trusts

It is always difficult for a person, no matter what profession he may be in, to come before a gathering of his peers and make a speech. This is especially true when the topic purports to be a fairly scholarly one, such as mine is today, and when some of you have so much practical experience in the very area of the law that I will be commenting upon.

Nevertheless, I am pleased to be with you and honored that you would extend to me another invitation to meet with you. As I indicated, my speech is in every sense of the word a "lawyer's" speech, not designed necessarily to entertain but, hopefully, to inform you about one particular function which my office performs.

At a time when there is so much talk about consumer protection, the environment, insurance rates, and anti-trust, I thought it might be refreshing to choose an area of activity which is not so close to the public spotlight, yet has a profound effect upon individual citizens throughout our State.

Let me begin by teasing you a little. I wonder how many of you can tell me what the following people have in common?

*a young man traveling around Europe in a sports car getting an "education" while his father gets a tax deduction (or could before the 1969 Tax Reform Act);

*a retired minister in this State - or his widow or orphan - receiving a monthly check for a bare subsistance;

*a trustee receiving $10,000 a year in this State for opening one letter;

*a hospital in Raleigh receiving a private "grant" to conduct an experimental program on a clinic for the poor;

*a trustee sitting in a $500 chair at a large conference table, receiving over $40,000 a year for going to ten meetings;

*a young, promising adult going to college on a scholarship or loan.

I am sure many of you have guessed that all of these people are "beneficiaries" in one way or another of charitable trusts - or "private foundations", as they are called by the Tax Reform Act.

Now you may think that this is a rather narrow area to use as the topic for a speech to the Bar of this County. However,

I suspect that many of you have been connected with charitable trusts in one way or another. And I think you would be interested in knowing that the City of Winston-Salem is saturated with trusts (Wachovia Bank, as you might suspect, is the trustee for most of them). Equally significant is the fact that the principal place of operation for the third largest trust in the United States - the Duke Endowment, with market value assets of $629,000,000 in 1969 - is located in North Carolina.

What does all this have to do with the Attorney General's office. Surprisingly enough, a great deal.

The Court, in STERNBERGER v TANNENBAUM, 273 NC 658 (1968), stated that "the State as parens patriae, through its Attorney General, has the common law right and power to protect the beneficiaries of charitable trusts and the property to which they are or may be entitled."

The Court went further to quote as authority, Am. Jur. on Charities, which states:

"Because of the public interest necessarily involved in a charitable trust or gift to charity and essential to its legal classification as a charity, it is generally recognized that the attorney general, in his capacity as representative of the State and of the public, is the, or at least a, proper party

to institute and maintain proceedings for the enforcement of such a gift or trust."

North Carolina has reinforced the mandate of the common law by imposing upon the Attorney General specific statutory duties in the area of charitable trusts. Article 4 of Chapter 36 of the General Statutes provides that in cases of mismanagement of charitable trusts, the Clerk of the Superior Court is required to give notice to the Attorney General or the solicitor who represents the county. It is then the duty of the one so notified to bring an action, in the name of the State, for an accounting by the grantees, executors, or trustees of the charitable fund.

The Attorney General may enforce, by a suit for writ of mandamus, any transfer for charitable purposes. Should a specific charitable purpose become illegal, impossible, or impracticable of fulfillment, the Attorney General may, where the settlor or testator manifested a general charitable intent, apply to the superior court for an order requiring administration to fulfill the general charitable intent.

In an action against the trustee of a charitable trust, upon a contract within his powers as trustee, the plaintiff is required to give notice by mail to the Attorney General of the existence and nature of the action. Failure to give the required

notice bars enforcement against the trust property of an ensuing judgment in the plaintiffs' favor. The Attorney General may intervene in such actions to contest the right of the plaintiff to recover.

The statutes requiring the Attorney General to perform certain duties relative to charitable trusts should not be construed as limitations upon his powers. He retains extremely broad statutory and common law powers in this area and it seems that, at common law:

> "Any question affecting a charitable trust may be brought before the court by information in the name of the Attorney General."

The Supreme Court of North Carolina seems to have adopted this broad view in its statement that, where charitable trusts are concerned, "If the Attorney General is not a necessary party, he surely is a proper party."

It is easy enough to see, therefore, the scope of responsibility which falls upon the Attorney General in North Carolina. It is easy enough to see that public interest requires that the management of charitable trusts be a continuing concern of our office.

But let's get back down to earth for a moment.

I was amused by the story told by one private attorney recently which sounds so typical of my own days in private practice. He said he once set up a foundation for a sweet, little old lady whom his firm had represented for years. There wasn't much money involved, maybe $15,000 a year. But from the attention she gave it, you'd have thought she was James B. Duke. She couldn't make up her mind.

One week she'd be big on Girl Scouts. The next week she'd pass a neighborhood park and decide to pay for the planting and care of a bed of flowers in a particular place. Or one of her friends would convince her that no charity was more deserving than cerebral palsy. Finally he got to the point that he "invented" a little law and told her that the tax laws wouldn't allow any more donations for six months.

This was an act of sheer desperation because he had discovered her foundation required four to six hours of his time each week and he couldn't in good conscience bill her for that much time. I certainly hope that trusts will "all be big ones", and that you will be spared this attorney's unhappy experience.

Regardless, charitable trust is a significant area of the law for me as Attorney General and for you as members of the legal profession, the public, and potential beneficiaries for several reasons. Let's look at some of them.

First, charitable trust administration under the 1969 Tax Reform Act is typical of an area of public concern where, for lack of effective action on the State level, the federal government stepped in and, in my opinion, over-reacted.

State Attorneys General, by and large, were not effectively supervising charitable trusts to prevent the tax dodge; the son-in-Europe example I mentioned earlier; the once-a-year meeting where already wealthy trustees take an unconscionably high fee for drinks, dinner and passing out the testator's accumulated wealth to the alma mater of one trustee, the hospital where the wife of another does charity work, or to the development of a park across the road from property owned by another trustee (the value of which incidentally will be enhanced considerably).

The truth is that the abuses were there; that the states, including North Carolina, declined to act; and that the Federal Government stepped in. I have said on many occasions that I am a proponent of State's rights but that state's rights are for responsible states. We can hardly be heard to complain when we stand by and allow abuse to exist unchecked and the Federal Government then decides to legislate in the area.

As is so often the case in such situations, the legislation which evolved - the Tax Reform Act - took on a punitive cast. Accumulations of income specifically provided for by the testator, often with the best of intentions, are now

questionable under the new Federal law. Malfeasance or nonfeasance by trustees is punished by penalties and fines directed against the trusts themselves - a contingency far from the mind of the testator himself. Detailed IRS reports are required and the Attorney General's office is the depository for copies of them.

The Federal Tax Reform Act dictated that the North Carolina trust statutes be amended, taking cognizance of the requirements of the federal legislation. G. S. 36-23.2 and G. S. 36-23.3 are repleat with references to the new Tax Reform Act.

Already my office has seen several instances where changes in charitable trust provisions have been required by the Act, many violating the clear intent of the testator.

It is significant, I think, thus far the original intent of the testator seems to have been well-intended and <u>not</u> a mere tax evasion technic in the cases we have had. However, the office is currently reviewing the operations of several trusts in this State which show signs of in-breeding. The same personnel establish and adminster the trust; they hold assets and income rather than distributing them for charitable purposes. Thankfully these are a small minority.

It is regretful that Congress approached tax reform with such a broad brush. It seems that from the beginning they adopted the notion that the whole barrel must have been spoiled by a few bad apples and proceeded to enact legislation which frustrated the legitimate intent of many testators.

Second, charitable trusts is an area which is typical of the Attorney General's common law authority supplemented by statutory powers to act as attorney for the general public. In the Kate Reynolds case, where cy pres was recently allowed by the Supreme Court, my office represented charity patients in hospitals around the State and any potential charity patient or person in need of health care who could not afford it.

In the Turrentine estate matter, in which my office is currently involved in Federal Court in the District of Columbia, I represent students who would receive scholarships and loans for attending the University of North Carolina where the trust is under attack because it provided for white students only.

More broadly, my representation in the Duke Endowment case is of Duke himself since we are opposing the request for change by the trustees, and the citizens of North Carolina have a continuing interest in the welfare of the Duke Endowment and the continuation of the investment of the Endowment's vast resources within this State.

I want to make my position in these cases clear, however. The trustees have a duty to uphold the trust and administer it as directed. If they come into court asking for some change in the administration of the trust, unless I am convinced beyond all doubt that there is no justification for the administration of the trust as directed by the testator, I will oppose the

cy pres request. In short, if the trustees bring the Attorney General into the suit, they can expect to have an active adversary.

Do not mistake my intent by this adversity. Just as I do not necessarily reject the notion that North Carolina needs an increase in insurance or utility rates by my active opposition of those actions, I do not reject the notion that cy pres is very often proper when requested by trustees. My posture in opposition is taken in the hope that the Court will be presented with all sides of the issues, with evidence that will support several conclusions and, where warranted, will provide an appeal in which something is really at stake for decision by the Court.

The responsibility of the charitable trustee is awesome. Allowed to exist in perpetuity, charitable trusts must be administered with flexibility to carry out well in modern society the intent of a testator who may have died nearly fifty years ago (as did James B. Duke).

Such trusts are the intermediaries between those who were or are willing to share their wealth and with the beneficiaries, usually some large segment of the general public. Trustees, in a very real sense, hold the assets in trust for the public and largely tax-free. Therefore, there is a special responsibility upon the trustees - and a special responsibility upon the Attorney General of this State.

As your Attorney General, I take this responsibility seriously. Christine Denson, who has the primary responsibility for overseeing our activities in the area of charitable trusts, does also. I want to take this opportunity here today to congratulate Chris on bringing to the forefront of our office's duties, this duty to protect the interest of the public in charitable trusts. As most of you know, she is an effective advocate, regardless of the cause, and already she has proved her ability in the trust field.