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Resisting the Corporatization of Nonprofit Governance: Transforming Obedience into Fidelity.

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RESISTING THE CORPORATIZATION OF NONPROFIT GOVERNANCE: TRANSFORMING OBEDIENCE INTO FIDELITY

Linda Sugin*

I. REFLECTIONS ON THE CONFERENCE

It is my privilege, as organizer of this conference, to reflect on the excellent papers published in this issue and the wonderful discussions that they inspired. The presentations left me with the impression that the law of nonprofit governance is moving toward a more corporate model of accountability—a model that emphasizes audits and other formal financial controls,¹ and that focuses enforcement on financial wrongdoing and misuse of charitable funds by directors and managers.² Along with these developments, it appears that the legal role of donors in nonprofit governance is growing, increasing donors’ ability to impose their vision on the organizations that they support.³ These trends are reflected in the models for nonprofit governance prepared by the Panel on the Nonprofit Sector and the American Law Institute (ALI). The panel’s report, Strengthening Transparency, Governance and Accountability of Charitable Organizations, closely followed a business model, stressing financial accountability.

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accountability, while devoting lesser attention to how organizations can be impelled to carry out their missions. The ALI Principles of the Law of Nonprofit Organizations explicitly adopted fiduciary obligations for nonprofit directors that were based on the principles applicable to business boards. These developments offer opportunities to improve the functioning and reliability of nonprofit governance. Financial controls, such as audit committees or mandated audits, would improve the reliability of the information available to donors and regulators. Eradicating stealing, excessive compensation, and misdealing within organizations is undeniably a worthy goal. In addition, increasing the range of remedies available to donors, compared to those available under current law, may bolster their support of the charitable sector.

Nevertheless, these developments cause me to wonder what nonprofit governance is for, and whether this legal course we are traveling leads to the ultimate end that we seek: effectiveness in carrying out charitable goals. We must analyze whether requiring—or even encouraging—conformity to a business model produces meaningful results for charitable endeavors. If the kinds of controls that the law institutes do not produce effectiveness for nonprofit organizations, they may do significant damage by steering the sector off course. Each of these business-type controls has costs of its own—some of which the papers in this book consider. Audit requirements and other financial procedures are expensive for organizations, diverting both resources and attention from charitable programs. Small organizations, in particular, might strain under such requirements. Thus, different regimes are necessary for large, sophisticated organizations and small, simple ones, similar to the system for business corporations. Ellen Aprill’s thoughtful analysis should make us wary of

4. Panel on the Nonprofit Sector, Strengthening Transparency, Governance, and Accountability of Charitable Organizations: A Final Report to Congress and the Nonprofit Sector 78 (2005), available at http://www.nonprofitpanel.org/final/Panel_Final_Report.pdf. The report was the Independent Sector’s response to the Senate Finance Committee’s invitation to self-regulate, rather than the subject of additional mandatory regulation. The overarching principles that the panel chose to guide its recommendations were couched in vague, somewhat aspirational terms, but its recommendations for government oversight were somewhat narrowly focused on preventing particular acts of wrongdoing. The recommendations suggest only that government should ensure effective enforcement of the law and deter abuse. The affirmative role of government enforcement is not only narrow, but skewed in the direction of financial control. The recommendations are designed to insulate the nonprofit sector in its substantive decision making by ensuring compliance with procedural safeguards and disclosure. This approach mimics the approach of corporate law.


generally adopting Sarbanes-Oxley-type requirements for nonprofit organizations. Rooting out wrongdoing is never easy, and misdealing is nothing new in (or out of) the charitable sector. Public scrutiny, however, has increased, creating the perception of a pressing problem where one might not really exist. Increased donor control, particularly dead-hand control, imposes costs on the legal system, which must devote public resources to litigating and carrying out the will of donors who may be long dead, and whose vision may be long outdated. Regardless of the outcome of the Robertson/Princeton dispute analyzed so well by John Eason in this book, the litigation has been costly in many ways.

Although it is unfortunate that there are insufficient resources to fully enforce good nonprofit governance, I do not believe that limited government resources are the central problem for nonprofit governance. Rather, the calls for greater regulation have focused on these types of issues because the core of what makes charities unique, desirable, and worth subsidizing is somewhat ephemeral and virtually nonjusticiable. While greater financial accountability might protect against certain abuses or mismanagement, it seems to promise precious little in fostering the affirmative public benefits for which charities exist, and threatens to subordinate the mission-related objectives within the governance structure of organizations.

This essay expresses concern over the creeping corporatization of the law of charities, and argues that these legal developments may inadvertently undermine the most compelling characteristic of these organizations. "Governments require no accountings of the methods by which nonprofit

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Regulation D, 17 C.F.R. §§ 230.501-.508 (2007). State corporate law governs the internal affairs for all corporations incorporated in the jurisdiction, but some states have special rules for small corporations. For example, over forty-five states have adopted the Small Company Offering Registration form, which is promulgated by the North American Securities Administrators Association and applies to the sale of securities up to $1 million. See, e.g., Sec. and Exch. Comm'n, Q&A: Small Business and the SEC § VII, http://sec.gov/info/smallbus/qasbsec.htm (last visited Sept. 15, 2007).


10. This is the perennial problem with mission accountability. See Brakman Reiser, supra note 8, at 218; Peggy Sasso, Comment, Searching for Trust in the Not-for-Profit Boardroom: Looking Beyond the Duty of Obedience to Ensure Accountability, 50 UCLA L. Rev. 1485, 1528 (2003).

organizations pursue their missions nor make any attempt to assure that charitable assets are used effectively or efficiently." But governments seem to be increasingly concerned with financial controls and structural elements, creating a dangerous illusion that our goal in the charitable sector is related to the bottom line. If we are too concerned with structural protections, like board size and director independence requirements, we may forget what those structures protect. While it has been argued that financial accountability is insufficient to ensure community relevance, the danger may be greater than ineffectiveness. Creating the wrong set of incentives may distract those in control of charitable organizations from the purposes for which such organizations exist.

In the conference proceedings, Burton Weisbrod argued that universities encourage college athletic coaches to sacrifice academics when they compensate coaches more highly if their student-athletes win games than if they excel academically. This essay follows through on that intuition by applying it to nonprofit governance generally. It argues that if we only create enforceable standards for the duties of loyalty and care—the fiduciary obligations that nonprofit and for-profit directors share—and if we create requirements of financial accountability only, then we should expect directors to conform their behavior to those standards. But those standards say nothing about charitable goals, and we can reasonably expect individuals to more vigorously commit themselves to missions where they have an incentive to do so. Some people are sufficiently self-motivated and do not need any legal impetus for mission commitment, but it is at our peril that we leave charitable goals to the good conscience of individuals.

The rest of this essay is organized as follows: Part II considers the fiduciary duties of nonprofit boards and observes that the emphasis in the law has shifted strongly toward equivalent obligations of loyalty and care for directors of both business and nonprofit organizations. Next, in Part III, I argue that the fiduciary duties of loyalty, care, and good faith might be sufficient for business corporations because, even in the absence of an explicit obligation to pursue profit, there are sufficient forces encouraging business managers to do just that. However, I maintain that business law duties are inadequate as the sole fiduciary obligations of nonprofit boards because the market mechanisms that function for business corporations are either weaker or do not exist for nonprofit organizations. In Part IV, I argue for a reinvigorated, but broader concept of obedience, which I describe as "fidelity." The obligation would be largely aspirational, as I am not

12. Fremont-Smith, supra note 11, at 2.
14. See, e.g., Brakman Reiser, supra note 8, at 218 ("There is no clear, independent metric for evaluating fealty to nonprofit mission."); Sasso, supra note 10, at 1527.
advocating a liability rule for nonprofit directors and managers who fail in their devotion to their mission. I believe, however, that its existence is central to the definition of the charitable sector and important as an anchor in the legal regime. The signaling effect of a separate obligation that applies only to those entrusted with nonprofit organizations is important and codifies the public responsibility that nonprofit boards have. A separate obligation establishes a norm that distinguishes the public role of those in control of charities from the purely private obligations of those in charge of business corporations.

II. WHY IS THE FIDUCIARY DUTY OF OBEDIENCE A STEPCHILD?

The directors of all corporations owe fiduciary duties of care and loyalty to those corporations. The duty of care concerns attention to the director’s task: It requires that “when becoming informed in connection with their decision-making function or devoting attention to their oversight function, [directors] shall discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances.”17 The duty of loyalty concerns conflicts of interest: It requires that a director put the interests of the corporation ahead of his personal interests.18 Connected to both of these obligations is the overarching requirement of good faith, which inserts a subjective element into directors’ duties.19

Some authorities identify a third fiduciary obligation that is unique to nonprofit directors: the duty of obedience. A leading casebook defines this duty as a “less recognized duty of board members . . . to carry out the purposes of the organization as expressed in the [organizational documents].”20 Covering a mere three pages in that text, the duty of obedience is clearly the stepchild to the duties of care and loyalty within the nonprofit canon. Furthermore, the future of the duty of obedience is very much at risk. Neither the Revised Model Nonprofit Corporation Act nor the statutes of any state includes a duty of obedience, even though many statutes have codified the duties of care and/or loyalty.21 The ALI’s Draft

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19. Revised Model Bus. Corp. Act § 8.30(a) provides, “Each member of the board of directors, when discharging the duties of a director, shall act: (1) in good faith, and (2) in a manner the director reasonably believes to be in the best interests of the corporation.”
21. See Fremont-Smith, supra note 11, app. at 514 tbl.3.
Principles reject a duty of obedience on the ground that such a duty conflicts with “the obligation to keep the purpose of the charity current and useful.” In her treatise, Marion Fremont-Smith also rejected it, explaining, “To the extent the duty of obedience does not carry with it a duty to assure that the trust is meeting contemporaneous needs, it does not set forth an appropriate standard.”

A. Trust Law Defines Obedience

It is not surprising that the duty of obedience fails the popularity contest—it is unattractively narrow and formal. It has been interpreted to require a rigid adherence to the purposes stated in an organization’s documents and therefore fails as a flexible norm requiring attention to charitable goals. The understanding of obedience reflects the trust law/corporate law tension that pervades the law of nonprofit organizations. While it is not clear why different forms of organization for charities have different legal standards applicable to the individuals controlling them, the historical development of nonprofit law in this country has created different rules for charitable corporations and charitable trusts. Although individuals starting nonprofit organizations may know nothing and care little about whether their organization is a trust or a corporation, the law implies different obligations for those managing charitable trusts than for those managing charitable corporations. The doctrine of obedience “derives from trust law [under which] a director (trustee) must administer the corporation’s assets (trust) in a manner faithful to the expressed wishes of the creator and donors, who rely on those express purposes when making their contributions.” Strict trust law parallelism would also impose “a trust on a charitable corporation’s unrestricted gifts . . . for those charitable purposes set forth in its articles of incorporation (and perhaps those manifested in its operations) at the time such gifts were received.” These trust strictures impose severe limitations on the power exercised by trustees and directors subject to them. Although the trust model has been applied to corporations, strict trust treatment for all contributions to nonprofit corporations has been largely rejected.

23. Fremont-Smith, supra note 11, at 226.
24. See generally Fremont-Smith, supra note 11.
25. See generally Evelyn Brody, Charity Governance: What’s Trust Law Got to Do With It?, 80 Chi.-Kent L. Rev. 641 (2005); Katz, supra note 11.
27. Katz, supra note 11, at 692.
28. The trust model was applied to California corporations prior to that state’s adoption of the Revised Model Nonprofit Corporations Act. See Pac. Home v. Los Angeles County, 264 P.2d 539, 543 (Cal. 1953) (providing that, where a charitable corporation organized for a specific charitable purpose accepts assets, this “establishes a charitable trust for the declared
Some state courts have applied the duty of obedience to nonprofit corporations, even though the statutes of those states do not mention the duty. In New York, the attorney general has decided that "the duty may be inferred by the limitations imposed upon corporate activities as set forth in the purposes clause of the certificate of incorporation (N-PCL §§ 201, 202 & 402(a)(2)) and the directors’ and officers’ obligations as the corporate managers of the not-for-profit organization (N-PCL § 701 & 713)."

The current understanding of the duty of obedience for corporate boards reflects Daniel Kurtz’s interpretation, which has been influential in the literature. He wrote, "A director is charged with carrying out the purposes of the organization, as expressed in the legal documents creating and defining its mission.... [D]iversion[] of corporate resources to other goals, no matter how laudable, [is] not legally justifiable." This approach takes the narrowest perspective—imposing trust-like obligations on directors of nonprofit corporations, despite the absence of trust-like standards in the statutes that control the use of corporate funds. Kurtz concedes that corporate directors "may have considerable latitude in determining precisely how such purposes can best be fulfilled." The distinction he makes seems to mirror the difference between cy pres and deviation in the trust context—allowing directors to engage in deviation unilaterally, but imposing a strict cy pres standard on purposes. For trusts, deviation concerns changes in administration of a trust, while cy pres goes to the heart of purpose and allows courts to approve changes in trust purposes when the original purposes become impossible to carry out.

Corporations purposes as effectively as though the assets had been accepted from a donor who had expressly provided in the instrument evidencing the gift that it was to be held in trust solely for such charitable purposes); cf. Thomas L. Greaney & Kathleen M. Boozang, Mission, Margin, and Trust in the Nonprofit Health Care Enterprise, 5 Yale J. Health Pol’y L. & Ethics 1, 66 (2005) (questioning whether pre-Revised Model Nonprofit Corporations Act cases that impose a trust on unrestricted gifts to charitable corporations remain good law in California).


33. See, e.g., N.Y. Not-for-Profit Corp. Law § 513 (McKinney 2004).

34. Kurtz, supra note 32, at 85 (citations omitted).

35. See Restatement (Third) of Trusts § 67 (2003).
a deviation case. Nevertheless, whether there is a deviation or cy pres, the standard is squarely based on trust law principles.

Although the duty of obedience is rarely judicially enforced, it has mostly been interpreted technically and narrowly, limiting the charitable goals of the organizations involved. A number of old California cases took a very strict view of obedience to the stated purposes of the organization. In one case, the court stated,

[A]ll the assets of a corporation organized solely for charitable purposes must be deemed to be impressed with a charitable trust by virtue of the express declaration of the corporation's purposes, and notwithstanding the absence of any express declaration by those who contribute such assets as to the purpose for which the contributions are made.

One narrow approach to obedience is through the ultra vires doctrine. While the ultra vires doctrine is nearly dead in the jurisprudence of for-profit corporations, it is potentially powerful in nonprofit enforcement if it defines the contours of an enforceable obligation of obedience. Under the traditional doctrine, an action is ultra vires if it is beyond the powers of the corporation. The ultra vires approach implies that the duty of obedience is specifically tied to the purposes in the corporation's internal documents, and that actions beyond those purposes are not within the corporate powers. In one case, a hospital was not allowed to cease performing the primary purpose for which it was organized, regardless of its other charitable activities. The issue was presented in narrow, ultra-vires-type terms, framing the question as whether the board exceeded its allowable powers by taking an action outside the permitted purposes of the organization. A recent New York case also approached the obedience question as one of ultra vires, adopting a formal understanding of the doctrine. In the compensation case of New York Stock Exchange President Richard Grasso, the court concluded that because Grasso had acted ultra vires, in the corporate sense, he had violated his duty of obedience. In fact, the duty of obedience seemed to pull little weight in the Grasso decision; the central argument in that opinion was about care, and to a lesser extent, loyalty.


This is consistent with the context in which obedience seems to arise in the cases—apparently, a violation of obedience alone is insufficient to warrant enforcement. But courts will mention obedience if other obligations are at issue, consistent with the duty's status as a stepchild in the law of fiduciary duties.

In an important decision that seems to enforce the duty of obedience without a specific ultra vires element, a New York court denied Manhattan Eye, Ear and Throat Hospital's (MEETH) petition to sell its assets. Although the court found that the deal would not produce fair consideration for the assets (which probably would have been sufficient to block the sale), it is a contemporary case on the duty of obedience because the court also grounded its decision on a finding that the charitable purposes of the organization would not be achieved by the sale. The deal contemplated that the organization's traditional hospital facility be closed and replaced by satellite clinic-type facilities. The attorney general opposed the sale and the court would not allow it to proceed because the hospital had received, but not considered, offers that would have preserved MEETH's acute care, teaching, and research functions. It is possible to read this case as a narrow interpretation of obedience because the court required that MEETH continue with its specific stated purpose—the operation of a hospital.

The most recent New York case on the issue took a measured view of obedience and a more flexible approach to the purposes in the organization's documents. In a dispute involving the Albright-Knox Museum, a New York court allowed the museum to deaccession works in the collection, and concluded that such deaccessioning would not create an obedience concern. The court allowed the museum to decide what kind of art it should hold in carrying out its mission. Perhaps this indicates a shift to a more flexible and dynamic interpretation of obedience.

B. Adopting a Flexible and Dynamic Interpretation of Obedience

The conflict between the stricter trust standard and the more flexible corporate standard in determining appropriate levels of discretion allowed to fiduciaries has hobbled the duty of obedience, making it a concept suited to trust fiduciaries but problematic for their corporate counterparts who are protected by the "best judgment rule," the nonprofit equivalent of the business judgment rule that allows corporate directors space in which to exercise their discretion.

41. Id. at 591–97.
42. Id. at 596–97.
43. That is not my reading of the case. See infra notes 71–77 and accompanying text.
45. Id. at *3.
46. This turn of phrase is revealing—business directors exercise business judgment, but the directors of nonprofit organizations exercise an undefined type of judgment.
which attach the duty to the purposes stated in a trust instrument or corporate charter, have overshadowed the potential for a legal norm to require commitment to a fundamental purpose to carry out charitable mission for the public good.

Rather than replicate the hazy distinction of trust law in the corporate context, the law would be better if we understood obedience at a more abstract level. I believe that the cases that Kurtz cites\textsuperscript{47} to support his distinction are, in fact, better understood as the application of a more abstract fiduciary duty, which I describe as “fidelity” rather than obedience, in order to distinguish it from the rigid trust-bound interpretation that has limited the doctrine. For example, Kurtz cites \textit{In re Multiple Sclerosis Service Organization of New York, Inc.}\textsuperscript{48} as a deviation-type case, but I believe that this case is better understood as more broadly defining the role of corporate directors in meeting their duty of obedience. The dispute in that case involved the choice of recipient organizations to receive the assets of a liquidating charity. The directors chose four recipients, but not the local chapter of the National Multiple Sclerosis Society, which sought to intervene in the dissolution proceedings. The court’s opinion explicitly rejected the cy pres standard for corporations, giving directors engaged in carrying out their fiduciary obligations the power to determine the scope of their organization’s mission.\textsuperscript{49} The court also interpreted the New York statute to require consideration of the activities of the organization, rather than binding the directors to the purposes stated in the organizational documents.\textsuperscript{50} Rather than representing a deviation standard within nonprofit corporate law, the case should stand for two important principles: (1) that courts defer to the directors’ judgment about the charitable goals of the organization, and (2) that the duty of obedience is carried out broadly with respect to consideration of the activities of the organization,\textsuperscript{51} rather than solely with reference to the purposes written in the documents. Inclusion of activities, as well as purposes, in determining the content of the duty of obedience, gives directors a dynamic responsibility in defining those activities over time.

This understanding of obedience is empowering for directors. It also gives substance to the obligation for directors of organizations that contain indeterminate purpose clauses in their documents. The connection of obedience to purposes stated in the organizational documents works in two ways—it is too limiting for organizations with narrow purpose clauses but meaningless for organizations with broad purpose clauses. It has long been

\begin{itemize}
\item \textsuperscript{47} See supra notes 32–34 and accompanying text.
\item \textsuperscript{48} \textit{In re Multiple Sclerosis Serv. Org. of N.Y., Inc.} 496 N.E.2d 861 (N.Y. 1986).
\item \textsuperscript{49} \textit{Id.} at 861–62.
\item \textsuperscript{50} \textit{Id.} at 867.
\item \textsuperscript{51} See also Queen of Angels Hosp. v. Younger, 136 Cal. Rptr. 36, 41 (Ct. App. 1977); Miami Retreat Found. v. Ervin, 62 So. 2d 748, 752 (Fla. 1952); Michael W. Peregrine, \textit{Charitable Trust Laws and the Evolving Nature of the Nonprofit Hospital Corporation}, 30 J. Health & Hosp. L. 11, 13 (1997).
\end{itemize}
standard for the organizational documents of business corporations to mimic the broadest enabling language of the statute, and nonprofit organizations can do the same and dispense with naming any particular charitable purpose. To be eligible for tax exemption, it is sufficient to organize a nonprofit corporation for any purpose allowed in Internal Revenue Code § 501(c)(3), without any more specifically stated purpose. Thus, if obedience is about narrow adherence to the purposes stated in the documents, then organizations that adopt the minimal necessary language to qualify for exemption would seem to lack any requirement of obedience. By focusing the obligation functionally on the regular activities of the organization, the duty of obedience can be understood as highly contextual and dynamic, reflecting the expectations of donors and the community in which the organization operates and the judgments of the organization’s managers and directors. Compared to the formalistic cy pres trust standard, this understanding of obedience is less restrictive than rigid adherence to the purposes stated in the organization’s documents for certain organizations, but more restrictive for others, depending on how purposes are defined by the organization’s documents. This interpretation of obedience guarantees a meaningful limitation based on charitable goals for all organizations.

Those who reject the duty of obedience as a separate identifiable norm are undoubtedly responding to its technical narrowness. The rigid connotations attached to it clash with the corporate business judgment rule model that has characterized the modern trend in nonprofit corporate governance, in which directors have broad power to change the organization’s priorities. “[T]he modern trend is to apply corporate rather than trust principles in determining the liability of the directors of charitable corporations, because their functions are virtually indistinguishable from

52. The Revised Model Nonprofit Corporation Act provides that “[e]very corporation incorporated under this Act has the purpose of engaging in any lawful activity unless a more limited purpose is set forth in the articles of incorporation.” § 3.01(a) (Exposure Draft 1986).


55. See Katz, supra note 11, at 692. The dispute between the majority and the dissent in Alco Gravure, Inc. v. Knapp Found., 479 N.E.2d 752 (N.Y. 1985), seems to have been about this point. Judge Matthew J. Jasen, in dissent, explained, “The theory advanced by the majority, that a not-for-profit corporation lacks authority to amend its corporate charter to change its corporate purpose, eviscerates the policy of the Not-For-Profit Corporation Law according charitable organizations broad latitude in corporate self-governance.” Id. at 759 (Jasen, J., dissenting).
those of their ‘pure’ corporate counterparts.” Requiring adherence to a fixed mission seems inconsistent with the power that directors of nonprofit corporations have to change the corporate mission by amending the corporation’s certificate of incorporation, though courts have stated that it would be appropriate for them to intervene with the directors’ decisions in instances in which “there is such a substantial departure from the charity’s dominant purpose as to amount to a perversion of it. . . .” There is no definition of purpose in the Revised Model Nonprofit Corporation Act and the default rule for purposes of a nonprofit corporation is “engaging in any lawful activity.” This guts the notion of any justiciable violation connected to corporate purpose.

This essay is sympathetic to those who reject the duty of obedience as rigid and inconsistent with the general approach of expansive board judgment adopted by contemporary scholars. Nevertheless, its main thesis is that the law should include a legal requirement that directors commit themselves to an organization’s charitable mission. I describe that obligation as fidelity, in order to separate it from the traditional notion of obedience to the purposes stated in an organization’s documents. Unlike


57. Greaney & Boozang, supra note 28, at 56 n.205 (“It has long been assumed that a board may alter its mission by amending its articles of incorporation.”); see also Banner Health Sys. v. Stenehjem, No. A3-02-121, 2003 WL 501821 (D.N.D. Feb. 25, 2003) (applying general corporate law principles under which the directors were virtually unrestricted in their ability to direct disposition of the general funds of the corporation, whether they were amending its charitable purposes or selling its assets and directing disposition of the proceeds); Att’y Gen. v. Hahnemann Hosp., 494 N.E.2d 1011, 1020–21 (Mass. 1986) (recognizing a nonprofit corporation’s board’s authority to amend its articles of incorporation to alter its mission); Revised Model Nonprofit Corp. Act §§ 10.01, 10.02(b), 10.30 (1987); Katz, supra note 11, at 697 (“Where corporate law parallelism prevails, there seems to be no intrinsic limit on the board’s ability to alter the corporation’s charitable purposes, so long as the requisite procedures are followed.”). But see Hahnemann Hosp., 494 N.E.2d at 1021 (dictum) (commenting that a charitable corporation that amends its articles lacks unfettered discretion to devote pre-amendment funds to new charitable purposes that are not similar or are even contradictory to its prior charitable purposes). In some states, the board may not amend the articles without outside approval. See, e.g., Ind. Code § 23-17-17-1 (2005).

The N-PCL requires a not-for-profit corporation to obtain State Supreme Court approval, upon notice to the Attorney General, before it may (1) amend its purposes or powers (N-PCL Article 8), (2) sell, transfer or otherwise dispose of all or substantially all of its assets (N-PCL Article 5), (3) merge or consolidate (N-PCL Article 9) or (4) dissolve (N-PCL Article 10). The Attorney General is a necessary party to the court proceeding and may file objections to the proposed terms. However, the court is the ultimate decision-maker.


58. Taylor v. Baldwin, 247 S.W.2d 741, 750, 757 (Mo. 1952) (en banc) (holding that Barnard Hospital’s acceptance of the affiliation contract was a reasonable exercise of the board’s discretionary powers and that the proposed affiliation would not depart from Barnard’s charter purpose).

59. Revised Model Nonprofit Corp. Act § 3.01(a).

60. See supra notes 52–53 and accompanying text.
the trust law notion, obedience is a flexible obligation that empowers directors to decide the course an organization will take. This duty incorporates a board’s power to change the purposes or the mission statement of the organization and never requires a board’s obedience to an outworn purpose in place of dynamic and responsive decision making. Nevertheless, I believe that some legal requirement is necessary and important because, without it, there is nothing in the law of nonprofit governance that affirmatively requires directors to strive for charitable goals. While loyal and careful governance, as those duties have been defined in the business context, might further a corporation’s mission, I am not convinced that they always will. A unique obligation applicable only to nonprofit boards has an important salience and performs a signaling function that makes it worthwhile, even if much of its content could conceivably be incorporated into other duties.

III. CORPORATE LAW OBLIGATIONS DO NOT QUITE FIT NONPROFIT BOARDS

There are advantages to adopting business law standards for nonprofit organizations. Where obligations are comparable, courts, attorneys general, and boards should use the corporate law standards to determine expected behavior for nonprofit boards. The wealth of precedent and interpretation of state law fiduciary obligations, particularly under Delaware law, should be helpful in guiding board members and their advisors. But there are many situations in which the rules applicable to for-profit organizations fail to capture the needs of nonprofits, and a tailored legal regime is necessary. If there is anything unique about charities, a one-size-fits-all approach to charities and businesses cannot recognize it.61

A. The Absence of a Market and a Profit Motive Matters

In both for-profit and nonprofit organizations, boards owe duties of care and loyalty to their organizations, and in neither type of institution does the satisfaction of those obligations ensure success in pursuing the organization’s goal. For business corporations, there is no guarantee that adherence to these fiduciary duties will translate into profits for shareholders, but, along with other forces, these duties encourage business executives and directors to make profits for the corporation. Care and loyalty may contribute to business success: If directors may not put their personal financial interests ahead of the corporation’s interests—the requirements of loyalty—then there likely will be more money left in the corporate till for the shareholders. If they must pay attention to the major events in the corporation’s life and oversee the work of the managers—the

61. Delaware, the preeminent state of incorporation for business corporations, and an increasingly popular state for nonprofit incorporations, has no separate nonprofit corporation statute, so, by definition, the obligations of nonprofit corporate directors must be precisely coextensive with the obligations of for-profit directors.
requirements of care—they may make better decisions about corporate strategy and prevent mismanagement and loss.

For businesses, it is the market that drives the profit motive most strongly, rather than the obligations of care and loyalty that underpin it. For example, executive compensation is often stock or stock-option based, so that managers stand to personally gain when shareholders prosper. There is a market for executive talent that judges managers by the profitability of the companies they run. The market for corporate control is also a powerful incentive—managers who want to keep their posts must strive to maximize efficiency to prevent unwanted takeover offers from bidders who believe they can improve the profitability of the business. Derivative and class action litigation by shareholders is also a disciplining force, since litigation is a regular by-product of a falling stock price, and the mere threat of those such lawsuits provides ample incentive for corporate managers to keep their focus on the bottom line. In business corporations, it is reasonable to assume that investors share a common desire to make profits, so market mechanisms that encourage attention to profit making help directors and managers stay focused on the appropriate goals. As a supplement to those mechanisms, the law can limit the extraneous goals that managers might impose on a corporation.

The market-driven regime breaks down for nonprofit organizations on two fronts: First, there is no market to keep the focus of individuals in control of nonprofits on a particular goal. Second, the goals of nonprofit stakeholders—including donors, beneficiaries, and the larger public—are likely to be more ephemeral and diverse than the common profit motive shared by the residual beneficiaries of businesses. Consequently, we can expect that the fiduciary model alone, without the assistance the market provides for business corporations, will be less effective than it is for business corporations. Nonprofit governance is not bolstered by either a market for corporate control or derivative litigation that focuses attention on the charitable mission. Litigation by individuals on behalf of a charitable organization against the directors or officers of that organization for misdeeds is impossible because standing rules prevent virtually all individuals from bringing suit. Only attorneys general, directors, and the Internal Revenue Service (IRS) are in positions to haul nonprofit directors into court at all, so the threat of crushing litigation and the aggressive plaintiffs’ bar are not an issue. Performance-based compensation, while familiar in the charitable sector, is not directly related to anything as concrete as financial-statement profitability or stock price, so its incentive

62. The lobbying cases recognize that shareholders might have diverse interests on issues not directly related to the business of the corporation. See First Nat'l Bank of Boston v. Bellotti, 435 U.S. 765, 784–85 (1978) (rejecting the theory of speaker's rights for First Amendment protection of corporate speech in favor of listener’s rights, which does not depend on a uniform speaker’s intent in the corporation).
effect is less direct than for business executives. There is no clear force that drives nonprofit directors and managers to achieve the good results for which their organizations exist; they must be self-motivated to an extent not expected of individuals in business organizations who are impelled by both fear and greed from external forces. While one could argue that attention to executive compensation in nonprofits and regulation to keep nonprofit salaries artificially low self-regulates for individuals committed to mission, it alternatively might select for less-skilled managers who cannot get higher-paying work elsewhere.

In a similar vein, it is possible to understand the selection of board members by particular organizations as a kind of market that identifies individuals who are most passionate about an organization's charitable mission. If we are confident that the individuals most passionate about an organization's goals make up the board, then we may not need a legally cognizable obligation to be committed to mission, but I am not convinced that this "market" functions very well. While many people are drawn to particular charities because they are dedicated to the organization's purposes, there are many individuals who choose to serve on boards for other reasons. Some are motivated as a favor to friends who are serving, or as a favor to an organization's executive director whom they want to support. Others are motivated by the prestige that board service can bring, and thus might choose a more prestigious board over a more obscure one as a status symbol, rather than out of a particular commitment to the work of the higher-profile organization. Some people are motivated by a general sense of obligation to give back to the community, though they may see the financial commitments that go with board membership as satisfying that obligation and believe that active involvement with mission is unnecessary. Thus, it would be a mistake to assume that boards are necessarily self-motivated by charitable goals.

Even individuals who feel a strong personal commitment may not be as motivated by that commitment as individuals stimulated by the external forces that encourage for-profit managers. The personal commitment that motivates charitable works is hard to measure and may be susceptible to fatigue. There are external pressures that motivate nonprofit managers, but they do not compare to those that motivate business managers. For example, nonprofit boards must worry about the loss of tax exemption. It is clear, however, that the threat of an organization's loss of exemption is remote and not nearly as compelling as the profit-making incentive that puts


money straight into an executive’s pocket. Without any corollary to those market mechanisms in the nonprofit sector, there needs to be a regulatory substitute. In nonprofit organizations, where market mechanisms do not operate, we should expect a higher level of regulation to compensate for the difference of incentives.65

B. Can Care, Good Faith, and/or Loyalty Ensure Fidelity?

Professor Harvey J. Goldschmid has argued that obedience is properly understood as a component of care.66 If the duty of care can embody the norms of fidelity to charitable mission, there is no need for a separate fiduciary obligation. Obedience and care are closely intertwined because a board’s consideration of the most effective use of an organization’s human and financial resources requires both care and fidelity. However, the responsibilities implied by both duties are not always identical. An understanding of care that embodies fidelity to charitable mission diverges from the corporate conception of care, frustrating the notion that business and nonprofit directors have the same obligations. To include the norm embodied in obedience as fidelity, the duty of care must include affirmative obligations to act on the part of directors and officers, and must be flexible enough to account for the different affirmative obligations of nonprofit directors and for-profit directors.

In the corporate context, the duty of care seems primarily concerned with information gathering and attention to relevant facts in making decisions. In the corporate context, however, the duty of care does not impose a substantive obligation to manage in any particular way. The Model Business Corporation Act treats the duty of care as an obligation to become informed67 and the statutes about care are largely concerned with situations when directors are allowed to rely on information provided by others.68 In the nonprofit context, there may not be enough content within the duty of care for it to do the work of requiring adherence to mission. A well-informed board could know that a charity spends most of its resources and energies running a business or planning galas, but having that information is not the same as obligating the board to change the course of the organization’s activities. In the business context, it may be fair to assume that if one is paying attention, then one will manage the corporation in a way that protects shareholders because there are so many extralegal forces.

65. While “takeovers” happen in the nonprofit sector, they are not a disciplinary tool that targets waste and mismanagement. Conversion from nonprofit to for-profit status has been a big issue in the health-care sector, but such takeovers only tangentially affect the mission objectives. Combinations that reduce wasteful duplication by different organizations do sometimes occur, but the proliferation of organizations suggests that duplication is created more often than it is reduced. See, e.g., Juliet Eilperin, Environmental Groups Join Forces, Wash. Post, May 15, 2007, at A13.
66. Goldschmid, supra note 54, at 641.
68. See id. at § 8.30(e); see also Del. Code Ann. tit. 8, § 141(e) (2001).
that incentivize corporate managers to pursue profit. But, as Professor Goldschmid has recognized, "[t]he obligation of nonprofit directors and officers with respect to the corporation's mission creates a more difficult and complex decision-making process for them than for their for-profit peers."69 If the duty of care is powerful enough to subsume obedience, then it should correspondingly include the obligation to pursue profit for business corporation directors, but it does not directly include that obligation. The furthest that the business law jurisprudence has progressed toward attaching affirmative obligations to the duty of care is the corporation's obligation to "shop" a company once the board has determined that it is for sale.70

To illustrate the relationship between care and obedience, consider the case of Manhattan Eye, Ear and Throat Hospital v. Spitzer,71 which I cited above at its face value for the proposition that the New York court interpreted obedience in the narrow sense of adherence to the organizational documents, and prevented the sale of the hospital because the duty forbade it.72 Though related to mission, the major problem in that case seems to have been a lapse in care—the board failed to determine, prior to deciding to sell the hospital real estate, that outpatient clinics would be a better use of the organization's resources than would running a traditional hospital.73 According to this case, the core content of care is information based, and a board fails to satisfy its duty of care if it pays insufficient attention to information readily available before making a decision.74 In MEETH, the court was concerned about the management process and whether the directors considered relevant information in that process. The MEETH board's decision-making process was flawed because it approached the problem backward—they first decided to sell and then considered what to do with the money. These are the core concerns of a care analysis, but not an obedience analysis, which is best interpreted as related to the substance of decisions.

69. Goldschmid, supra note 54, at 641.
70. See Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 369–70 & n.37 (Del. 1993) ("[T]he directors were inadequately informed (of alternatives, or of the consequences of executing a merger and related agreements). An auction is a way to get information. A pre- or post-agreement market-check mechanism is another, less effective but perhaps less risky, way to get information. A 'lock-up' is suspect because it impedes the emergence of information in that an alternative buyer that would pay (or would have paid) more is less likely to emerge once such an impediment is in place." (citation omitted)).
72. See supra notes 41–43 and accompanying text.
73. The board may not have even realized it was making the decision it made. The court stated, "[T]he minutes show, the Board did not seem to believe that it was actually closing the Hospital. One has to wonder exactly what the Board thought it was doing." MEETH, 715 N.Y.S.2d at 585.
74. MEETH is actually quite reminiscent of the classic Delaware case that held directors liable for a breach of the duty of care. In that case, the board decided to sell the company without properly investigating whether the price was adequate. See Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).
If the MEETH directors had first fulfilled their duty to be informed, and then concluded that they should sell the hospital so they could provide better care for the medical conditions they were organized to ameliorate, the court would likely have concluded that they satisfied their obedience obligation, as well as their care obligation. This is why the obedience question is tied up with the care question: In some circumstances, the same evidence will show that both obligations are satisfied. Because the MEETH board had not based its decision on sufficient investigation, the court was not prepared to give it the benefit of the best judgment rule, which would have protected the substantive decision the board made about what to do with the organization’s resources. If the board had first consulted the doctors and experts in the medical field and concluded that the hospital services provided by MEETH were no longer needed in New York City, the court should have deferred to the board’s judgment under general corporate law principles. The board and the doctors were certainly in a better position than the court to exercise judgment about whether the services they were offering were underutilized or redundant and whether they could, in an alternative organizational structure, provide better medical care for people suffering from particular diseases. The MEETH board might have been required to undergo the procedure for amending their corporate documents, but they had the statutory power to do so. The essence of obedience is the substantive obligation on which the duty of care helps a board to focus. To require a hospital to continue to offer surgical procedures after the medical community has shifted away from those procedures to safer or less intrusive nonsurgical methods is perverse, and no reasonable interpretation of obedience should require it. It appears from the opinion that the attorney general’s office was not particularly interested in enforcing such a rigid conception of the duty of obedience but was more concerned about the organization receiving fair value for its assets. A well-informed MEETH board committed to its mission may still have had a problem in the litigation because the court found that it failed to get the highest price for the assets.

75. They had, apparently, started that process. MEETH, 715 N.Y.S.2d at 584.
76. The attorney general’s office seemed most concerned about the sufficiency of consideration to be paid in the deal, and that a fair auction would be held. Id. at 587. Even if MEETH satisfied its care obligation and determined to sell its real estate and move the hospital operation intact to a less valuable location in the city, the attorney general should still have objected to the sale because it allowed the loss of assets from the charitable sector. The board had inexplicably voted to sell the real estate for less than the appraisal they had received. Id. at 581.
77. Under the first prong of the test in New York Not-for-Profit Corporation Law § 511 (McKinney 2004), which MEETH had to satisfy for the court to approve the deal, the board had to get a fair and reasonable price for the assets sold. Since the deal involved a sale of some assets to a developer, some of the assets would no longer be used in the charitable sector. If MEETH had dissolved, it would have been permitted to distribute its assets to another functionally similar organization without any consideration. If the deal in MEETH had been simpler and MEETH’s facility became part of Sloane-Kettering’s cancer center, the obedience question would have been isolated, front and center. In that case, I can imagine a
Even if care could do the work of obedience, it is preferable to have a separate affirmative obligation that makes clear that nonprofit directors and officers have different obligations than their for-profit counterparts. If nothing else, a separate duty of obedience to the organization’s mission highlights the distinction between governing a business and governing a charity. If it is merely a signal of the importance of mission, the signaling effect is worthwhile. Separating out a duty of obedience from the duty of care makes it more apparent to directors with little preparation for nonprofit governance that their job specifically includes a substantive obligation to actively carry out the charity’s mission.

The ALI Draft Principles of the Law of Nonprofit Organizations turns to good faith and loyalty, rather than care, to provide the substantive content that I am arguing should be provided by a separate duty of obedience understood as fidelity. It treats good faith as an overarching obligation that imbues both care and loyalty with the subjective requirement to act in the charity’s best interests. Loyalty is defined as acting in a manner the board member “reasonably believes to be in the best interests of the charity, in light of its stated purposes.” Both of these descriptions include attention to the goals of the charity’s work, the core of obedience, and as with care, good faith and loyalty are certainly tied up with the organization’s purposes. Nevertheless, I am wary about good faith carrying that burden in charity governance because the ALI’s description seems to go beyond the understanding of good faith in the corporate context. The obligation of good faith sets too low a bar in the governance of business organizations. Even at its strongest, for example, in the Delaware Chancery Court’s Disney opinion, the obligation of good faith only required that directors not act with complete disregard to the consequences of their decisions. Good faith, thus, means that directors may not completely ignore their responsibilities, which falls significantly short of an affirmative obligation to carry out the charity’s mission.

Loyalty may be more a promising instrument of obedience than good faith because the ALI definition of loyalty incorporates mission—it describes loyalty specifically as loyalty to the charitable purpose of the organization, rather than simply loyalty to the organization. In addition, the vernacular understandings of loyalty and obedience are similar, so a

79. Id. § 310. The comment to that section describes fiduciary duties as running to the charitable purposes. Id. § 310 cmt. a(1).
board member untrained in nonprofit service might reasonably expect that loyalty implies commitment to the goals of the organization. However, the same problem that makes me wary about the breadth of good faith leads to concern that loyalty would not clearly include a robust obligation of fidelity. The business law fiduciary concept of loyalty is about subordinating one’s personal interests to the interests of the corporation: it arises in the context of interested-director transactions, controlled corporation acquisitions, and executive compensation. There are equivalent situations in the nonprofit sector for some loyalty issues. For example, the interested-director transaction raises the same issues for business corporations and nonprofit organizations. Where the law establishes procedural mechanisms for addressing conflicts of interest in transactions where the director has an interest on both sides, it is reasonable that the same mechanisms should apply whether a fiduciary sells property to a business or a nonprofit on whose board he serves.

While some have suggested raising or lowering the standards for nonprofit directors compared to for-profit directors, there are enough similarities with respect to those types of transaction to justify a uniform standard. The conflict-of-interest issues generally associated with loyalty, which are amenable to procedural protections, are not quite the same as an obligation of obedience. Such a duty requires adherence to the organization’s mission, even where an individual’s personal interests are not implicated at all. To incorporate fidelity into the duty of loyalty requires that the duty of loyalty move beyond mere consideration of an individual’s personal interest and embrace a more affirmative obligation to the organization’s particular vision. This more active and operational notion of loyalty seems out of place in the larger context of the structural loyalty issues that arise in corporate law. Furthermore, the object of a director’s duty of loyalty is the key part of obedience as loyalty, but that object is less precise and less personified for a nonprofit organization. For business corporations, fiduciary obligations run to the entity, as they do for nonprofit corporations, but it would be odd to describe directors as obligated to make widgets, though that would seem to be a parallel interpretation to the mission obligation for nonprofits.

83. See Revised Model Nonprofit Corp. Act § 8.31(a)-(c) (Exposure Draft 1986) (describing procedural mechanisms to approve a conflict of interest transaction).
85. This is the position of many commentators. See, e.g., Goldschmid, supra note 54, at 649 (accepting parallel standards, but calling for increased scrutiny of certain conflict of interest transactions).
86. An independent committee of the board is a common mechanism for addressing divided loyalties of a controlling shareholder. See, e.g., Kahn v. Lynch Commc’o., Sys., 669 A.2d 79, 81 (Del. 1995).
In sum, it seems that loyalty and care are very much enmeshed with obedience, but I am not convinced that they encompass the scope of obligation embodied in a separate duty. In the business context, the duty of care and the duty of loyalty are composed largely of procedural or structural elements, as opposed to substantive ones. Adherence to mission is a substantive determination, so any obligation defined by process alone is insufficient to regulate it. In addition, a regime that limits the fiduciary duties to care and loyalty, without obedience, may foster an inappropriate balance of authority and discretion between managers and boards. Those duties alone make it more likely that boards concern themselves only with financial controls and procedures, leaving development of mission to the professionals who work for the organization. As many charity boards are large and some board members see their major role as fund-raiser for the organization, a standard of behavior that includes only care and loyalty shifts responsibility to the executive director and staff for mission accomplishment. While an organization's professional staff may have greater knowledge and/or greater personal passion for the charitable mission, the board is an invaluable resource for mission strategy. If nonprofit organizations are to be governed by boards, then boards must not micromanage, but they must at least set policies and consider strategic plans for the organization. A model of fiduciary duties limited to care and loyalty emphasizes the board's important role as monitor, but diminishes its other crucial governance functions.

C. A Duty That Captures the Public Nature of Nonprofits

Beyond the differences that arise from the lack of a market, which alone should make us wary about adopting the corporate model wholesale into nonprofit law, the nature of the fiduciary obligations of loyalty and care need more definition in the nonprofit world. Unlike the obligations of corporate directors for the benefit of shareholders,87 fiduciary obligations to a charitable organization are not as clearly for the benefit of any single identifiable interest. It is possible that the obligations protect the interests of donors, who simply take the place of shareholders in corporations that lack them; the mechanisms designed to protect shareholders in the business corporation can translate well enough into protection for the donors in the nonprofit organization. To the extent that we think about business corporations as agglomerations of shareholder money, and charities as

87. Corporate directors may not elevate the interest of other stakeholders above the interest of shareholders, because they may then breach their duty to shareholders. See Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 181 (Del. 1986). Even in states with so-called other constituency statutes, directors may consider the interests of non-shareholder stakeholders, but their obligation to shareholders is still paramount. See Eric W. Orts, Beyond Shareholders: Interpreting Corporate Constituency Statutes, 61 Geo. Wash. L. Rev. 14, 94 (1992) (“Constituency interests may figure in a board’s deliberations, but decisions to defend against a tender offer . . . may not significantly disfavor the long-term interests of shareholders.” (internal quotation marks omitted)).
conduits for donor money, the corporate model might be acceptable. Some of the literature takes this donor-centered approach. The duty of obedience, like the other obligations in the nonprofit context, might then be in the service of protecting donors' implicit or explicit expectations. Then, we could easily answer the question posed in the title of this essay by asserting that it is to protect the interest of donors.

Protection of donors seems too narrow for the purposes of nonprofit governance. Excessive protection for the interests of donors threatens the statutory power of directors to manage an organization and creates a real danger that donors may cause "illegitimate mission creep" by diverting the purposes of the organization away from the goals and activities chosen by directors and managers. Without additional legal protections, donors have tremendous power under contract law, as they define the terms of their gifts. A donor-centered perspective on nonprofit fiduciary duties conceives of the charitable organization as essentially private, and ignores the crucial public interest in the governance of nonprofit organizations and the mechanisms by which they determine their missions.

A conception of nonprofit governance as a struggle between donors and managers is too shallow, even though it parallels the corporate law conception in which shareholders and managers are in a principal-agent relationship. The manager-centered perspective for nonprofit


89. See Brakman Reiser, supra note 8, at 213 ("When individuals opt to become affiliated with a nonprofit, as volunteers, donors, members, staff, or beneficiaries, they expressly or implicitly rely on [its mission statement]."). In Queen of Angels Hospital v. Younger, the court pointed to the fact that the organization had solicited funds for hospital purposes as a reason for disallowing use of those funds for outpatient clinics. 136 Cal. Rptr. 36, 41 (Ct. App. 1977); see also Trustees of Rutgers Coll. v. Richman, 125 A.2d 10, 26 (N.J. Super. Ct. Ch. Div. 1956) (recognizing that a principal rationale of the duty of obedience is the reliance of donors on an organization's faithfulness to its purpose).

90. See Revised Model Nonprofit Corp. Act, § 8.01(b) (1986) ("[A]ll corporate powers shall be exercised by or under the authority of, and the affairs of the corporation managed under the direction of, its board.").

91. Brakman Reiser, supra note 8, at 272.

92. Cf. Nicole Lewis, Controversy over Donor's Role Causes Smithsonian to Lose $36.5-Million, Chron. of Philanthropy, Feb. 21, 2002, at 16 (noting that the Smithsonian lost most of a $38 million pledge from the Catherine B. Reynolds Foundation to underwrite an exhibit on American achievers, after Reynolds determined that the exhibit would not focus enough on "the power of the individual").

93. See Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 657 (Del. Ch. 1988). I do not find the principal-agent analysis for business corporations particularly compelling either, since directors of business corporations have statutory authority to manage their companies. The agency cost analysis that arises from this perspective differs for nonprofit and for-profit organizations. See Robert A. Katz, Can Principal-Agent Models Help Explain Charitable
organizations is insufficiently responsive to both the private interests that donors legitimately have, and the public interest of stakeholders with competing visions. While managers are likely to be in the best position to define and direct the organization because they are in the position with greatest information, their discretion must be tempered by a legal standard that affirms the charitable mission and that donors can rely on when they choose to support a particular organization.

In the corporate context, tremendous discretion for corporate directors, coupled with strict legal requirements for disclosure and process, sets the terms of a nexus of private contracts. Corporate managers are not permitted to mislead investors in taking their money, but they can decide how to run the company with the money they have amassed once they have it, subject to minimal government oversight and limited shareholder participation. This is the bargain that shareholders strike when they invest, and we can accept it, given that neither party was obligated to enter into the contract in the first place. For charitable organizations, the contract includes the public at large, which has no choice about participating.

Some commentators have identified the public interest on the beneficiary side of charitable organization, but have characterized the donor side as purely private. But it is more accurate to describe the public as partners in the creation of charitable organizations on account of the charitable contribution deduction that subsidizes a donor's original gift, and the government's acceptance of the responsibility to enforce restrictions on gifts in perpetuity. While government may not be a direct funder or donor, the public is a financial partner in every charitable organization that is eligible to receive deductible contributions and exemption from income tax. These subsidies, in addition to other privileges that charities enjoy, give them a truly public aspect from their inception, and the public has an interest in maximizing the effectiveness of an organization in carrying out its charitable purposes. Charities are subject to more mandatory rules and higher levels of government oversight precisely because they are more public than business corporations. For the same reason, they are also entitled to government benefits to which business corporations lack access.


94. See Katz, supra note 11, at 710.

95. This discussion about the public/private nature of nonprofit organizations assumes a donative organization in which contributions are significant, and the public subsidy under the charitable contribution deduction is meaningful. But many organizations are funded through other means. Of course, public funding argues for public interest. But even organizations heavily financed by fees paid by individuals or private institutions, such as universities and hospitals (though Medicare and Medicaid are significant public sources of funding) have a strong public dimension that derives from other government oversight, such as certification and licensing schemes. Hospitals are heavily regulated for public health reasons and even for-profit universities need to comply with accreditation procedures. Nonprofit organizations, such as universities, that depend on fees may raise particular concerns about market failure and may have a uniquely important role to play in civic society.
An additional problem with treating donors as shareholder equivalents arises when there is not a single major donor, but rather a group of diverse donors to an organization. The concerns of donors may diverge or even conflict, strengthening the public interests compared to the private interests of donors. The private perspective on charitable purposes is only coherent for charities where a single individual or small group of donors started a charity with a very specific idea about its mission. But it weakens as we consider public charities funded by many individuals and institutions, each of whom might have an independent reason for choosing a particular charity. Recognizing that charities are public partnerships at their creation alters the public/private dynamic of charities so that there is never a wholly private interest to be protected.

Thus, to treat the directors of charities like business corporation directors, and to treat donors like shareholders, is to miss the role that charities play in public life. Increased participation by donors may reset the balance between donors and directors/managers of charities, but that participation does not guarantee integrity of charitable mission to the class of beneficiaries or the larger public. If government oversight of charities is equal to government oversight of business corporations, then the public’s interest, by definition, has not received sufficient attention. A distinct obligation for directors, coupled with government oversight of that obligation, is necessary to address the unique public/private nature of nonprofit organizations.

The distinction between the public and private aspects of organizations uniquely involves the duty of obedience. For duty of care and duty of loyalty, there is not as much of a conflict between the public and private conception of the organizations. Whether the law protects donors in particular, or the public interest in charitable works more broadly, the duty of loyalty would have the same content—both private donor interests and public interests are harmed by diversion of charitable assets into private hands. A similar analysis is also appropriate for the duty of care—both private donor interests and public interests are harmed if directors pay no attention to whether charitable assets are invested poorly or mismanaged by others, and all individuals charged with managing institutions should be required to pay attention to their task—not a very demanding threshold.

The public/private nature of charities is important in defining boards’ responsibility to their missions. The private perspective that treats donors as shareholders supports the narrow and technical interpretation of obedience described above. That perspective allows donations to be understood as contracts between organizations and their donors to pursue specific goals: if a donor gives to a charity with a particular purpose in its

96. This perspective would suggest less dead-hand control for donors than the law has generally accepted. Even in the most restrictive trust instruments, regulators would have an obligation to carry through on the expectations of public investment implicit in the subsidy provided by the donor’s government partner.

97. See supra Part II.A.
organizational documents, then we enforce that donor’s expectations by requiring adherence to that narrow purpose, which we impute to the donor. Allowing funds to support broader charitable uses would be contrary to those private expectations, even though those broader uses might be a more efficient and effective use of a charity’s funds, both in the opinion of the charity’s managers and directors and the broader public. The public perspective on fiduciary duties of nonprofits allows a much broader interpretation of obedience because the public interest in charitable goals is necessarily much broader than the interest of individual donors. Some cases seem to embrace this public perspective on mission accountability.  

There are other provisions in the laws of states with special nonprofit statutes, outside the definition of fiduciary duties, that recognize this public nature of nonprofit organizations and distinguish them from businesses. For example, the important role of a court or the attorney general in reviewing proposed amendments to an organization’s certificate of incorporation reflects a public view of the nonprofit corporation. It signals the interest of outsiders in the mission of the organization. The court’s or attorney general’s participation substitutes for that of beneficiaries who lack standing to challenge any changes in corporate purpose. An expansive approach to the class of potential beneficiaries gives directors, courts, and the attorney general more freedom to interpret charitable mission.

Recognizing the public/private nature of nonprofit organizations is increasingly important as more for-profit organizations describe their work as “social entrepreneurship.” Both charities and businesses are able to do good for society—they are both in positions to improve our standard of living, protect the earth, lift individuals out of poverty, etc. Nobody claims that good works are the unique province of nonprofit organizations.


99. See, e.g., N.Y. Not-for-Profit Corp. Law § 804(a)(ii) (McKinney 2004). Every certificate of amendment of a corporation classified as type B or type C under section 201 (Purposes) which seeks to change or eliminate a purpose or power enumerated in the corporation’s certificate of incorporation, or to add a power or purpose not enumerated therein, shall have endorsed thereof or annexed thereto the approval of a justice of the supreme court of the judicial district in which the office of the corporation is located. Ten days’ written notice of the application for such approval shall be given to the attorney-general.

Id.


101. I have previously argued that the distinction that the tax law makes between business expenses and charitable gifts of corporations is indefensible, and that allowing corporations to deduct all payments to charity as business expenses may help maximize the social good produced by corporations. Linda Sugin, Encouraging Corporate Charity, 26 Va. Tax. Rev. 125 (2006).
So what distinguishes nonprofit charity from for-profit social entrepreneurship? I believe that the distinction relates to the duty of obedience to mission, and that the distinction between philanthropic organizations and business organizations, as a legal matter, is about the fundamental obligations of directors and the parties to whom the directors owe these obligations. The absence of a duty of obedience, the one unique responsibility of nonprofit boards, is a problem in the face of increased for-profit philanthropy.

The crucial difference between for-profit social entrepreneurship and nonprofit philanthropy is that only those in control of charitable organizations have the privilege and responsibility of subordinating all interests to the charitable mission of the organization. For charities, all private goals are subordinated to mission and there can be no compromise between the private interests and the public interests that the charity serves. The non-distribution constraint that characterizes nonprofit organizations is the consequence of the adherence to mission, not vice versa. The constraint guarantees that the organization will be operated to achieve its mission, and never for the benefit of shareholders or other private interests. As soon as profits can be paid out to individuals, the role of directors becomes unclear and conflicted. No board can simultaneously treat its charitable mission and its shareholders' private pecuniary interests as paramount. At some point, those interests are likely to become incompatible, and the law must be clear about whether directors must sacrifice ideals for profits, or vice versa. Separating nonprofit and for-profit organizations is necessary to preserve these legal standards, and to give any fiduciary obligations content. With the rise of for-profit philanthropy, increasing the resemblance of nonprofit governance to for-profit governance is a mistake because it fosters a type of accountability that is more suited to serving the private goal of profit than the public goal of mission.

IV. CREATING A CONTEMPORARY NORM OF FIDELITY TO CHARITABLE MISSION

In Part II, I described the duty of obedience as the stepchild fiduciary obligation, and consistent with that role, it has not been well enforced. The cases that discuss it generally rely on other causes of action as well. Under

102. See I.R.C. § 501(c)(3) (2000) (requiring for exemption that "no part of the net earnings ... inures to the benefit of any private shareholder or individual"). See generally Henry Hansmann, The Ownership of Enterprise (1996).

103. In the business context, the constituency statutes adopted by some states to allow directors to consider non-shareholder interests have been criticized for watering down the fiduciary obligations of shareholders. If a board may consider anyone's interests, it is more likely to be accountable to nobody. See generally James J. Hanks, Jr., Playing with Fire: Nonshareholder Constituency Statutes in the 1990s, 21 Stetson L. Rev. 97 (1991); Mark E. Van Der Weide, Against Fiduciary Duties to Corporate Stakeholders, 21 Del. J. Corp. L. 27 (1996).
standing rules, individual donors are virtually foreclosed from bringing lawsuits based on the duty of obedience, leaving it to state attorneys general to define and enforce it. Attorneys general, however, are not clamoring to take on that role. Information about enforcement proceedings is not easy to acquire and there is little public disclosure of settlements. Under the current legal regime, it is "nearly impossible to hold a charitable fiduciary liable for breach of [any] duty except in the most egregious circumstances, often only if criminal behavior were involved." Only financial impropriety leads to significant enforcement efforts by attorneys general, whether framed in terms of care, loyalty, or obedience violations. Nonfinancial problems may not be considered sufficient for devoting government enforcement resources. In this part, I defend an enforceable duty of obedience, explain how it would apply, and consider ways that it might be enforced.

Some may be wary of an enforceable duty of obedience because it can give regulators too much power as arbiters of effectiveness for nonprofit organizations; attorneys general sometimes define the public interest in surprising ways. Measuring effectiveness may be the most intractable problem that charities have: Because their goals rarely translate into measurable returns, and are often long-term, there may be no way to measure success in a timely way, or at all. Shorthand measures commonly used, such as percentage of revenue used for overhead, are not necessarily useful because lack of overhead may coincide with lack of program evaluation or careful design. Without profits as a measure, it is virtually impossible to determine effectiveness for many kinds of charitable organizations. Going forward, nonprofits will increasingly need to establish metrics that will allow them to gauge their success.

105. As the Supreme Court of California noted, The Attorney General may not be in a position to become aware of wrongful conduct or to be sufficiently familiar with the situation to appreciate its impact, and the various responsibilities of his office may . . . make it burdensome for him to institute legal actions except in situations of serious public detriment. Holt v. Coll. of Osteopathic Physicians & Surgeons, 394 P.2d 932, 935 (Cal. 1964).
107. Fremont-Smith, supra note 11, at 53.
108. For an excellent discussion of mission accountability connected with asset protection, see Brakman Reiser, supra note 8. Once a financial impropriety is identified and enforcement is undertaken, a court may find violations of more than one duty. See, e.g., People ex rel. Spitzer v. Grasso, 836 N.Y.S.2d 40, 42 (App. Div. 2007); Att’y Gen. v. Hahnemann Hosp., 494 N.E.2d 1011, 1017–18 (Mass. 1986).
110. See Brody, Whose Public?, supra note 54 (describing the dubious actions of the state in the dispute over the investment policies of the Hershey Trust).
Whether there exists a legally enforceable duty of obedience to mission is largely about the appropriate limits of law and legal rules. The law can no more enforce success on charities than it can enforce profits on businesses. The law needs to develop an understanding of the obligation that requires that nonprofit directors and managers are engaged in the pursuit of the kind of public benefits that justify the pedestal on which charities stand in the community. This is why I prefer to think of the obligation as fidelity to mission, rather than obedience. Fidelity lacks the oppressiveness, inflexibility, and control over policy by long-dead founders that obedience implies, and captures the loftiness of the responsibility. A contemporary conception of the obligation can empower boards without freeing them completely from legal constraint.

A. What Would Fidelity Do?

The nature of obedience that needs reinforcement in the law is closely connected to the overarching theme of this conference—the economic challenges facing charities today, because economic challenges are most likely to threaten boards’ full commitment to mission by distracting their attention from charitable goals toward resource accumulation. Nonprofit boards today must spend tremendous time and energy building endowment or raising a capital fund. The conception of obedience as fidelity allows boards the substantial discretion that would allow directors to exercise judgment about the direction of an organization. But, it would stop at the limits of a reasonable interpretation of charitable mission.

As an example, consider again the MEETH case, discussed above. If the obedience failure in MEETH was changing the method for delivering particular health-care services, as the court suggests, the concept is too restrictive. Alternatively, obedience as fidelity would support directors in their decision of how best to carry out the health-care mission of the organization. If the hospital’s certificate was too narrow to allow the resources to be used for another medical purpose, fidelity to mission would not prevent the board from amending its organizational documents to allow the assets to be so used. The obedience problem arises otherwise in the MEETH case, and can be understood along the lines described here because it was a case in which the board allowed the hospital’s high real estate value to blind it to its health-care mission’s primacy. The directors violated their duty of obedience as fidelity to charitable mission because they allowed the prospect of money to distract them from their charitable goals. If the MEETH board sacrificed mission for money, as directors may often be tempted to do when they are sitting on valuable real estate or intellectual property, their duty of fidelity should require that they subordinate those

111. See supra notes 41–43, 71–77 and accompanying text.
112. This excludes restricted assets, which must be used according to the terms of their contracts. See N.Y. Not-for-Profit Corp. Law §§ 801–802 (McKinney 2004) (empowering directors to amend certificates of incorporation).
economic interests. There is nothing in the duty of care or the duty of loyalty that would explicitly require them to make that choice.

Obedience as fidelity should be understood as a bolster to the best judgment rule, rather than as a limitation on it, because it comfortably coexists with extensive powers for boards to modify an organization’s purposes. While it is possible to argue that empowering directors to change purposes undermines the notion of obedience, I believe that it frees obedience from the narrow purposes stated in the documents and instead connects it to the broader charitable purposes motivating the institution. This is how care and obedience come together—the board must exercise care in evaluating the charitable goals and effectiveness of the organization. If the purpose clause in the organizational documents fails to address current charitable needs, the board should be allowed to change it. While a court might review the care with which the board reached the decision, and the attorney general may have a participatory role in the process, it is appropriate for judicial review to be highly deferential to the reasoned decisions of charity boards.

Obedience as fidelity empowers boards to exercise their judgment in the name of mission by allowing them to depart from business law constraints. For example, a decision to forego revenue by offering free or low-cost services where the market might tolerate a higher price would be justifiable, as would be a decision to forego maximum exploitation of assets, or to rebuff a lucrative offer for the sale of real estate or operations. While a waste claim can always be made against a for-profit board, even if it has satisfied care and loyalty, obedience should be a defense to such a claim for a charity that can show its decision carried out charitable goals.

As an example of obedience filling the void left by care and loyalty, too much attention to endowment building may present a violation of directors’ duty of fidelity, though endowment building is clearly consistent with care and loyalty. In a recent letter from Senators Max Baucus and Chuck Grassley to Secretary of the Treasury Henry M. Paulson, Jr., the senators inquired about the federal “commensurate in scope” doctrine, and requested guidance from the Treasury that “will put more teeth into the commensurate test.”113 That tax law doctrine is under defined under current law,114 but the senators’ understanding of it as “charities need[ing] to provide charitable work commensurate with their resources” reflects the impetus behind an obligation of fidelity to charitable goals.115 More specifically, the duty of

115. A current payout requirement for public charities might be one mechanism by which the Internal Revenue Service can partially enforce what I am advocating as a state-law fiduciary obligation.
obedience might limit the power of donors to make restrictions on gifts that divert the attention of an organization’s board and managers from the charitable goals of the organization to wealth accumulation. The press has recently reported on T. Boone Pickens’s gift of $50 million to two Texas institutions. The gifts came with the requirement that those institutions make the $50 million grow to $500 million within twenty-five years or lose the money at that time.\(^{116}\) While the restrictions may be legal under current law, the gift does not seem like a great deal to the recipient charities.\(^{117}\) Nevertheless, it is hard to turn down $50 million, even when it has strings attached.

The duty of fidelity, by legally obligating boards to pursue charitable goals, should serve to limit the level of micromanaging that donors can achieve by using restricted gifts. It must be the clear duty and privilege of the board to determine the course that an organization will take. While a fiduciary obligation that strengthens boards vis-à-vis donors might discourage some gifts, some gifts might not be worth their costs. An invigorated duty of fidelity could empower charities to resist these types of gifts and could also discourage donors from attaching such cumbersome restrictions on their gifts.\(^{118}\)

### B. Is Fidelity Enforceable?

Legal rules imply enforceability, so the difficulty of enforcement may be an argument against codification as a legal rule. But legal rules also imply norms and expectations at a more persuasive level than model codes of conduct, so it is important that fidelity have the status of a legal rule. I am not advocating a liability-creating rule, but fidelity could nonetheless be effectively enforced directly or indirectly. Nonprofit enforcement has embraced various remedies that are more promising and constructive than monetary liability for breaches of duty.\(^{119}\) Only where a fiduciary has profited at the organization’s expense does a monetary remedy seem to address the wrongdoing.\(^{120}\)

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\(^{118}\) To the extent these gift restrictions burden charitable goals, the tax law rules on deductibility could also help to discourage them in favor of unrestricted gifts by delaying the deduction until the restrictions lift, or by subjecting restricted donations to lower percentage limitations under I.R.C. § 170(b) (2000). Under current law, a gift with too many conditions may not constitute a current gift at all; payment is required. I.R.C. § 170(a)(1).

\(^{119}\) See Brody, *supra* note 2.

\(^{120}\) Monetary liability seems less suitable for nonprofit breaches of duty than for breaches by business boards because of the economic structure of charities compared to business corporations. The monetary remedy in business corporations may help ameliorate the “other people’s money” problem that characterizes the public business corporation. That problem is less severe in charities that rely on donations because board members are generally big donors to the organization, so their lapses in judgment are often misuses of
Laws can be flexible without being arbitrary and enforcement can be tailored to achieve results. Removal of directors may be an effective remedy.\textsuperscript{121} The Sibley Hospital court required that all directors read the court’s opinion as an education mechanism.\textsuperscript{122} In the Getty Trust investigation, the California attorney general has maintained oversight of the foundation as part of its resolution of the matter.\textsuperscript{123} While I am not endorsing any particular remedy, and I am troubled by the possibility of parochialism in enforcement,\textsuperscript{124} diverse and creative remedies are a promising development because they suggest that regulators are working to design solutions that will improve the operation of organizations and preserve assets in the charitable sector. For financial wrongdoing, requiring that the wrongdoer make the organization whole seems a reasonable remedy, but for fidelity problems, a legal remedy that sets the organization back on course should be uniquely responsive.

One commentator has suggested that the duty of obedience can be enforced “through the development of internal norms that facilitate a culture of trust” between the board and the organization’s managers.\textsuperscript{125} Her solution is a reorganization of the nonprofit board to include more manager-employees on the board and reduce the size of the board so that those manager-employees are a powerful bloc. While trust in the boardroom is certainly important to the smooth functioning of an institution, the duty of obedience as fidelity must be an external norm, as well as an internal one. Obedience deserves status as a legal norm with a legal solution because it is the public interest that fidelity ultimately protects; it needs a public representative such as the Attorney General or the IRS. It must be enforced from outside an organization and with regard to the public benefits that an organization has a responsibility to serve. Fidelity must protect against the capture of charitable organizations by any private interest—whether those interests are the private interest of donors, managers, or individual board members. In nonprofit organizations, there is as much danger from a board too dependent on the judgment of the executive director as there is from one too conflicted with him.

The closest we come to enforcing a fidelity requirement is the federal tax law, since the state attorneys general do not seem to enforce obedience without connection to other breaches of fiduciary duty or financial impropriety. Eligibility for exemption requires that organizations be both

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\item Stern v. Lucy Webb Hayes Nat'l Training Sch. for Deaconesses & Missionaries (Sibley Hospital), 381 F. Supp. 1003, 1019 (D.D.C. 1974).
\item See Brody, Whose Public?, supra note 54.
\item Sasso, supra note 10, at 1545.
\end{enumerate}
\end{footnotesize}
organized and operated for enumerated charitable purposes. These requirements have been interpreted to cover the documentation and practice of organizations, and a very broad notion of obedience as fidelity to any charitable purpose, could be enforced in that way. "Since the duty of obedience requires the directors to uphold the organization's founding documents, which require the organization to operate for a charitable purpose, operating for non-exempt purposes would be an ultra vires activity." The question is whether there is any more narrow limitation appropriate in understanding the contours of fidelity.

The unrelated business income tax (UBIT) encourages directors and managers to connect revenue generation to their charitable missions. By taxing revenue arising from non-mission-related activities, those activities become more expensive and, consequently, less attractive. Managers can invest the organization's money without tax liability in passive investments, which presumably require less of their attention than do active businesses. Perhaps the UBIT has worked splendidly in this regard since surprisingly few organizations seem to have unrelated businesses. The recently adopted requirement that organizations disclose their UBIT returns may be an additional incentive to organizations to avoid unrelated businesses. Disclosure is a good enforcement mechanism when incentivizing desirable behavior is sufficient to carry out the underlying policies. The UBIT taxes certain activities, without prohibiting them, but the incentive that it creates may go a long way toward forcing managers to keep their eyes on the status of their charitable goals. Federalization of obedience in the UBIT rules is consistent with the duty's status as the stepsister of care and loyalty. Just as care and loyalty are directly enforced under state law, their violation, as interpreted in the tax law through the rules barring inurement and private benefit, are grounds for revocation of exemption. The UBIT, on the other hand, has a greater parallel to aspirational standards in state fiduciary duty law because it gives charities incentives to hew closely to their missions, but does not punish them too harshly if they veer away. They may be taxed, but their exemption is not at risk.

Additional disclosure requirements may be the most effective mechanism for enforcing obedience as fidelity. Under the federal securities laws, disclosure is the cornerstone of public company regulation, and there is a well-developed industry that makes determinations about companies based

on their public disclosures. A mandate to companies to disclose audited and certified financial statements assumes that stakeholders can get reliable, material information from those disclosures that might affect their decision about investing in a company. While various stakeholders might be concerned about the uses of funds in a nonprofit organization, financial statements are unlikely to give the most meaningful information about whether an organization is achieving its mission. Donors, beneficiaries, and members of the general public all care about whether the organization adequately serves the needs of the community that it is designed to serve. As a tool, IRS Form 990 is more informative than the financial statements of an organization. The Form 990 has long required not only detailed information about the organization’s investments and expenses, but also about the relationship of activities to accomplishment of exempt purpose. It allows a potential donor to see how the organization’s expenses are divided between program services, management in general, and fund-raising. In its recent redesign, which is scheduled to become effective for 2008, the Form 990 demands more specific and tailored financial information about organizations. To the IRS's credit, the revised form does not simply adopt the corporate model of financial statements. For example, the new Form 990 will include more specific information about activities in which an organization engages, including political activities, activities outside the United States, and a special new schedule for hospitals that provides information about services performed and community benefits.

The Form 990 is a promising mechanism for increasing mission accountability of nonprofits. While Form 990s are required by law to be publicly available and are readily available on the Internet, most people are unaware that they can easily locate and understand them. I would support a requirement that charities provide links to their Form 990s on their own web sites as a way to improve accountability generally and encourage greater adherence to mission specifically. Members of the public interested in donating, patronizing, or otherwise interacting with the organization are very likely to visit its web site, but quite unlikely to come

131. See Basic, Inc. v. Levinson, 485 U.S. 224, 231 (1988) (adopting the materiality test from TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976), to apply to the sale of securities). "[A]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." Id. (quoting TSC Industries, 426 U.S. at 449 (internal quotation marks omitted)).
133. Id. pt. II.
across the Form 990 otherwise. That the Form 990 is different from the disclosure required by business organizations is important, even though its primary function, like Securities and Exchange Commission filings for public corporations, is the disclosure of information.\textsuperscript{137}

Other disclosure requirements might serve to create incentives to achieve charitable goals as well. Disclosure is a more meaningful disciplinary tool in the era of the Internet and is a relatively cheap requirement to impose on organizations, particularly where they are required to disclose information they are already obligated to prepare. In addition to the Form 990 disclosure, states could require web site disclosure of charities’ self-assessment of their operations. While this might be somewhat costly to prepare, it would serve to ensure that boards reflect on their goals and progress, which would serve obedience, but also care. It would add some teeth to the best practices conduct standards that do not currently have the force of law.

Finally, the press has long played an important role in nonprofit enforcement, but that role has not been institutionalized in the law. Press scrutiny of nonprofit organizations and the repercussions that charities suffer from bad press may help enforce fidelity, as a practical matter, and future attention to the role of the press in the legal enforcement of fiduciary duties may be worthwhile. Regulators tend to follow up on abuses identified by the news media,\textsuperscript{138} and the public responds to information about misdeeds.\textsuperscript{139} Public confidence in charities has declined since Hurricane Katrina.\textsuperscript{140} The considerable power of the press may imply an important function for journalists in enforcing the fidelity obligation of nonprofit organizations.

In sum, it seems foolhardy to try to develop a more enforceable and justiciable duty of obedience to be carried out by the courts. Attorneys

\textsuperscript{137} This differs from many tax forms, which have a primary function of payment of taxes.

\textsuperscript{138} Investigation of the Getty Trust was started on account of articles published in the \textit{Los Angeles Times}. See Lockyer, supra note 123.

\textsuperscript{139} While there is limited information, the anecdotal evidence clearly suggests that the market for donations responds to public knowledge of wrongdoing. Several articles indicated that the post-9/11 Red Cross publicity had repercussions for the national charitable sector. See Donald A. Moore, \textit{Restoring Faith in Charities Means Giving a Voice to Donors}, Chron. of Philanthropy, Nov. 29, 2001, at 37. The extremely high visibility of the cause led to general public suspicion about the use of charitable funds and calls for additional scrutiny that have not gone away. See Stephanie Strom, \textit{Faith in Charities Still Below Pre-9/11 Level}, N.Y. Times, Nov. 27, 2003, at A28.

\textsuperscript{140} Professor Paul C. Light has completed an empirical study on public perceptions of charitable giving in which he found that more than forty percent of the American public has “no confidence or not much confidence” in U.S. charities, compared with about thirty-three percent who said they lacked such trust before Hurricane Katrina. See Jacqueline L. Salmon, \textit{Red Cross, Humane Society Under Investigation}, Wash. Post, Mar. 26, 2006, at A10. The press prominence of the child sexual abuse scandal in the Catholic Church had a severe negative impact on donations; in a recent study, one in nine regular churchgoers indicated that the crisis had led them to reduce their giving. See, e.g., Sam Dillon, \textit{Abuse Scandal Is Deterring Catholic Donors, Poll Says}, N.Y. Times, Nov. 9, 2002, at A14.
general charged with charity governance have insufficient resources to handle the range of regulation they currently oversee. While the IRS is increasingly in the business of charity governance,\textsuperscript{141} it has limited resources for enforcement as well. We need to design incentives that will bolster the enforcement of an obligation of obedience, so that attention to the underlying goals of an organization do not fall by the wayside as nonprofits improve their financial reporting and increasingly model their governance structures on their business counterparts.

CONCLUSION

The law of nonprofit governance is undergoing an exciting transformation, and has wisely borrowed from the law of for-profit corporate governance. While nonprofit organizations resemble their for-profit counterparts in many ways, they differ in important respects that the law must recognize. The public nature of nonprofit organizations fundamentally distinguishes them from their business counterparts, and regulatory mechanisms must substitute for the market incentives that control business behavior. This essay has argued for a reinvigorated and redefined duty of obedience for nonprofit directors, which I have called “fidelity.” “Obedience” is problematic because it has been interpreted too rigidly, but the law needs something to take its place because the corporate obligations of care, loyalty, and good faith are insufficient for nonprofit directors. The obligation of fidelity creates a legal norm requiring adherence to charitable goals, while allowing directors considerable flexibility and discretion. Fidelity distinguishes nonprofit directors from business directors, signaling the importance of charitable mission for nonprofit organizations and requiring subordination of all other substantive goals.
