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Strengthening Charity Law: Replacing Media Oversight with Advance Rulings for Nonprofit Fiduciaries

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Strengthening Charity Law: Replacing Media Oversight with Advance Rulings for Nonprofit Fiduciaries

Linda Sugin*

This Article considers three urgent challenges facing the charitable community and its state regulators: too little fiduciary duty law for nonprofits, the rise of media enforcement of wrongdoing in charities, and an inherent tension in the state's dual role as enforcer and protector of the nonprofit sector. It analyzes whether the scarcity of law is really a problem by comparing nonprofit organizations with business organizations and concludes that charities lack the self-enforcement mechanisms of businesses and therefore need more government guidance. It evaluates whether the media has made governmental supervision obsolete and expresses skepticism about the press displacing state oversight. The solution presented, an advance-ruling procedure for fiduciary duty questions, proposes that states shift their focus from better enforcement against wrongdoers ex post to better charity governance ex ante by devoting more attention and resources to assisting well-meaning charity directors in carrying out their fiduciary obligations.

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I. INTRODUCTION

Imagine you are on the board of trustees¹ of a charity. The executive director reports that the organization is in terrible financial trouble. She presents several options: sell off long-held assets owned by the organization and use the proceeds to make ends meet; drastically reduce services and programming that the organization provides; borrow money and increase the organization's ongoing obligations and risk; or merge with another, larger organization that will ultimately obliterate the unique character of the charity. All seem undesirable to you, and you do not know if you are obligated to choose any particular one. Alternatively, consider your response if the executive director reports positive results for the organization's operations and proposes a massive expansion of the organization's activities and scope that will fundamentally change the nature of the charity's services and operations. You are nervous about the organization taking on new risks and are concerned about its relationship with current beneficiaries and the community. But it is not clear to you whether the risk is responsible or whether you are in a position to protect current beneficiaries and the community (or if you should). Finally, imagine instead that the executive director's proposal involves business dealings between the organization and another member of the board or a relative of the executive director. Something may not smell right to you about the proposal, but if the price seems fair, you may not be able to put your finger on what it is.

These issues are common for nonprofit fiduciaries, but solving them requires nuance and judgment. If you are like most people who volunteer to serve on charity boards, you want to do the right thing for the organization and the community. You volunteered because you believe in the charity's mission and want to support it.² But there is a good chance that you do not know the right thing to do under the law. The legal obligations of charity boards are not widely known or easy to discover, and state attorneys general (AG)—who are responsible for the oversight of charities—have numerous other responsibilities demanding their time and resources. So the people who run charities often muddle along, doing their best, without much legal guidance.

1. This Article will refer to "trustees" and "directors" interchangeably. They are the people on the governing board of a charity, whatever its form. Charities can have various state law forms, including both trusts and corporations.

2. See *infra* note 96 and accompanying text.

Those who think of the nonprofits as superfluous—a bonus on top of the essential government and business sectors—may be satisfied with mediocrity in the nonprofit world. But they should not be. Nonprofits play a crucial role in the economic, social, and cultural life of society.³ Well-functioning charities are needed to provide a broad array of public and private goods, including social services, higher education, and the arts. Nonprofits address important public needs, even though they are privately managed. States have an interest in the effective operation of charities because the better charities are run, the more they can contribute to their public missions and overall social welfare.⁴ States have an interest in good charity *governance* because they have an interest in good charitable *services*. Unlike business organizations, which bring tax revenue and economic spillover into a state,⁵ a state's charities bring a higher quality of life to the people of the state.

This Article considers three urgent challenges facing the nonprofit community and its state regulators: too little fiduciary duty law for nonprofits, the rise of media enforcement of wrongdoing in charities, and the inherent tension in the state's dual role of enforcer and protector in the nonprofit sector—what I call the “confidentiality paradox.” First, there are surprisingly few cases concerning fiduciary obligations of nonprofit directors.⁶ Scholars who would adopt

3. In 2010, public charities reported \$1.51 trillion in revenue and \$2.71 trillion in assets. See Amy S. Blackwood, Katie L. Roeger & Sarah L. Pettijohn, *The Nonprofit Sector in Brief: Public Charities, Giving, and Volunteering, 2012*, URBAN INST. 1 (2012), <http://www.urban.org/uploadedPDF/412674-The-Nonprofit-Sector-In-Brief.pdf>. Nonprofits paid 9.2% of all wages and salaries in 2010. See *Quick Facts About Nonprofits*, NAT'L CENTER FOR CHARITABLE STAT., <http://nccs.urban.org/statistics/quickfacts.cfm> (last visited Mar. 1, 2015).

4. In order to qualify for tax exemption, charities must be “organized and operated exclusively” for public purposes defined in the statute. I.R.C. § 501(c)(3) (2012).

5. Delaware has attracted a disproportionate share of business organizations, which produce substantial franchise tax revenue for the small state. There is no similar competition among states for charities. See Garry W. Jenkins, *Incorporation Choice, Uniformity, and the Reform of Nonprofit State Law*, 41 GA. L. REV. 1113, 1161-62 (2007).

6. My research revealed only the following published cases finding breaches and applying remedies: *Boston Children's Heart Foundation, Inc. v. Nadal-Ginard*, 73 F.3d 429 (1st Cir. 1996); *Lifespan Corp. v. New England Medical Center, Inc.*, No. 06-cv-421-JNL, 2011 WL 2134286 (D.R.I. May 24, 2011); *Aramony v. United Way of America*, 28 F. Supp. 2d 147 (S.D.N.Y. 1998); *Stern v. Lucy Webb Hayes National Training School for Deaconesses & Missionaries*, 381 F. Supp. 1003 (D.D.C. 1974); *Macaluso v. Jenkins*, 420 N.E.2d 251 (Ill. App. Ct. 1981); *Shepard of the Valley Lutheran Church of Hastings v. Hope Lutheran Church of Hastings*, 626 N.W.2d 436 (Minn. Ct. App. 2001); *State ex rel. Little People's Child Development Center, Inc. v. Little People's Child Development Center, Inc.*, No. M2007-00345-COA-R3-CV, 2009 WL 103509 (Tenn. Ct. App. Jan. 9, 2009); *Summers v. Cherokee Children & Family Services, Inc.*, 112 S.W.3d 486 (Tenn. Ct. App. 2002); *Marist*

business law principles into the law of nonprofit organizations fail to see a problem of too little law because they would borrow from business law precedent.⁷ But in the context of fiduciary duties, business law is woefully inapt for nonprofits.⁸

Second, the proliferation of charity-rating and monitoring institutions⁹ has altered the landscape from legal to nonlegal oversight for charities. Private watchdogs, along with the media, have become the most important enforcers of charity fiduciary behavior. In some cases, the media leads while the state authorities follow with enforcement action, but sometimes, media enforcement supplants governmental oversight altogether.¹⁰ For individuals involved in charity misdeeds, media enforcement is a shaming remedy. Shaming may be effective in controlling the behavior of some fiduciaries, but we should be skeptical about its equity and efficiency. The media may get the standards wrong, may sensationalize stories to grab attention, and may yield net negative effects on the charitable sector and society as a whole.¹¹ The privatization of legal standards threatens the states' control over the definitions of good charity governance and wrongdoing, and it is imperative that states reassert their crucial role.

Third, a confidentiality paradox exists because there is a tension inherent in the charities enforcement work of the AG between effectiveness in a particular case and usefulness to the charitable sector as a whole. Confidentiality is good for a charity under investigation, but bad for others who would learn from its mistakes. Unlike the Internal Revenue Service (IRS), which regulates charities in the course of policing their tax exemptions, state AGs are protectors of the

College v. Nicklin, No. 01-94-00849-CV, 1995 WL 241710 (Tex. App. Apr. 27, 1995); and *John v. John*, 450 N.W.2d 795 (Wis. Ct. App. 1989).

7. I have previously written about why business law fails to suit the policies of charity law. See Linda Sugin, *Resisting the Corporatization of Nonprofit Governance: Transforming Obedience into Fidelity*, 76 FORDHAM L. REV. 893 (2007).

8. See discussion *infra* Part II.C.

9. See, e.g., BBB WISE GIVING ALLIANCE, <http://give.org> (last visited Mar. 1, 2015); CHARITY NAVIGATOR, <http://www.charitynavigator.org/> (last visited Mar. 1, 2015); CHARITY WATCH, <http://www.charitywatch.org/home> (last visited Mar. 1, 2015); *GiveWell Blog*, GIVEWELL, <http://blog.givewell.org/> (last visited Mar. 1, 2015); *Watchdog*, STAN. SOC. INNOVATION REV., <http://www.ssireview.org/blog/category/watchdog> (last visited Mar. 1, 2015).

10. See, e.g., Kathleen Teltsch, *United Way Awaits Inquiry on Its President's Practices*, N.Y. TIMES (Feb. 24, 1992), <http://www.nytimes.com/1992/02/24/us/united-way-awaits-inquiry-on-its-president-s-practices.html> (stating that William Aramony's behavior had been uncovered in "several publications").

11. See discussion *infra* Part III.B.

charitable sector.¹² The state's role is as *parens patriae*,¹³ so its object in overseeing charities is to protect the public good.¹⁴ Effectiveness in AG enforcement implies preservation of charitable assets. These goals often counsel secrecy and settlement by the state with a charity under investigation without legal enforcement proceedings. Where the AG can reform a charity and improve its governance by demanding internal changes in structure, process, or policies, confidentiality is desirable so that the charity suffers no loss of donors or public embarrassment. Except in the rare situation in which a charity is fraudulent at its core,¹⁵ or there is no public benefit that it provides, a targeted remedy that corrects a problem is best for minimizing damage to a particular charity's mission and perhaps to the reputation of the charitable sector as a whole. Unfortunately, secrecy and unpublished settlement are prime causes of the lack of law. If participants in the charitable sector—particularly lawyers—had greater knowledge of both the issues raised in AG investigations and the solutions designed with the input of the state, they would be in a better position to advise nonprofit boards on how to behave.

Improving charity governance requires balancing diverse concerns for individual organizations, the charitable sector, and the public at large. Even with scarce resources, states need to create more law for nonprofits, so innovation in lawmaking is essential. This Article proposes that states shift their focus from better enforcement against wrongdoers *ex post* to better governance *ex ante*¹⁶ by devoting

12. See Karen Gano, *The Fundamental Role of the States in Governance Issues*, COLUM. U. ACAD. COMMONS 1, 3 n.4 (2013), academiccommons.columbia.edu/catalog/ac%3A168598.

13. Latin for “parent of the nation,” which in the legal context refers to the state having standing to sue on behalf of its citizens. See *id.* at 1 (“The Attorney General’s duty arises from the responsibility of the *parens patriae* as representative of the indefinite members of the public—the public at large—who are the beneficiaries of property devoted to charitable purposes.” (emphasis added)).

14. A visit to any state AG’s website describes their role as protecting the “public good.” See, e.g., N.Y. ATT’Y GEN., <http://www.ag.ny.gov> (last visited Mar. 1, 2015); *Protecting Consumers*, ILL. ATT’Y GEN., <http://www.illinoisattorneygeneral.gov/consumers/> (last visited Mar. 1, 2015).

15. See, e.g., *A.G. Schneiderman Announces \$500k Settlement and the Shuttering of Three Long Island Sham Charities and Their Professional Fundraiser*, N.Y. ATT’Y GEN. (Feb. 4, 2014), <http://www.ag.ny.gov/press-release/ag-schneiderman-announces-500k-settlement-and-shuttering-three-long-island-sham> (“[T]he charities were shell organizations run primarily for the benefit of the fundraiser and the charities’ officers, and that less than 4 percent of the money raised went to any charitable purpose.”).

16. This is consistent with the approach of the Leadership Committee for Nonprofit Revitalization. Leadership Committee for Nonprofit Revitalization, *Report to Attorney*

more attention (and resources) to assisting well-meaning charity directors in carrying out their fiduciary obligations.

The next section, Part II, describes the minimal legal enforcement of fiduciary obligations in nonprofit organizations. It analyzes whether the scarcity of law is really a problem by comparing nonprofit organizations with business organizations. Part III considers the media's role in oversight of nonprofit governance and explains how the importance of reputation in the charities world has allowed the media to effectively displace legal authorities. It evaluates whether the media has made governmental oversight obsolete and expresses skepticism about the press displacing state enforcement. Part IV suggests a solution to the identified challenges by advocating an AG-based advance-ruling process for fiduciary duty questions, modeled on the private letter ruling procedure administered by the IRS. It argues that such a process would be an equitable and efficient alternative to media enforcement, would create a body of useful legal advice, and would be preferable to other suggestions in the literature for addressing the problem of inadequate charitable fiduciary oversight. Part V briefly concludes.

II. WHERE IS THE LAW IN NONPROFIT GOVERNANCE?

A. *What Is Charity Law?*

Charity law consists of both federal law and state law. Organizations are subject to substantial regulation in the federal tax law in order to be eligible for exemption. Only organizations qualifying as charities may receive tax-deductible contributions from donors,¹⁷ so they are the gold standard for tax-exempt institutions. The IRS provides that charities may not pay profits out to individuals (the "inurement" prohibition), must be organized and operated for a statutorily-enumerated purpose, and are restricted in their political activities.¹⁸ Much of the federal law applies to activities by organizations, but such regulation necessarily implicates the behavior of the individuals who control them. As the tax enforcer, the IRS is responsible for policing the boundaries of charitable organizations.

General Eric T. Schneiderman, N.Y. ATT'Y GEN. 23-34 (Feb. 16, 2012), <http://www.ag.ny.gov/sites/default/files/NP%20Leadership%20Committee%20Report%20%282-16-12%29.pdf>.

17. I.R.C. § 170 (2012).

18. *Id.* § 501(c)(3). There are organizations that are exempt from tax, but are not charities. *See id.* § 501(c).

State law directly regulates the behavior of nonprofit directors, imposing fiduciary duties on individuals who are in control of charitable organizations.¹⁹ While the precise terms of law differ across states, all states mandate that charity directors exercise care in their decision making²⁰ and elevate the interests of the charity over their personal interests, if they ever conflict.²¹ In addition, individuals in charge of charities have an obligation to carry out a charitable mission.²² These fiduciary concepts are vague, and governing charitable organizations is not easy.²³ Not only has the number of organizations grown in recent years,²⁴ but the complexity of their structures and operations has increased as well.²⁵

States do not dictate “how to ‘do’ charity,”²⁶ but state AGs oversee charity behavior; they are responsible for enforcing the obligations of loyalty, care, and obedience that fiduciaries have under the laws of

19. See Jenkins, *supra* note 5, at 1126-27; see also N.Y. NOT-FOR-PROFIT CORP. LAW § 717(a) (2014) (imposing fiduciary duties on leaders of charitable organizations).

20. New York law provides a succinct definition for care: “Directors and officers shall discharge the duties of their respective positions in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances.” N.Y. NOT-FOR-PROFIT CORP. LAW § 717(a). To satisfy the obligation, “trustees must affirmatively exercise discretion and make a deliberate judgment.” J. Edward Meyer et al., Report to the New York Board of Regents on Adelphi University Trustees, IND. UNIV.-PURDUE UNIV. INDIANAPOLIS 16 (Feb. 5, 1997), <https://folio.iupui.edu/bitstream/handle/10244/502/THE%20COMMITTEE%20TO%20SAVE%20ADELPHI.pdf?sequence=1>.

21. See DANIEL L. KURTZ, BOARD LIABILITY: GUIDE FOR NONPROFIT DIRECTORS 59 (1988) (“The basic duty of loyalty . . . requires a director to have an undivided allegiance to the organization’s mission . . . when using either the power of his position or information he possesses concerning the organization or its property.”). The famous quote in the corporate context, equally applicable to nonprofits, is Judge Cardozo’s description of the duty as “[n]ot honesty alone, but the punctilio of an honor the most sensitive.” *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928). The Model Nonprofit Corporation Act requires that directors act “in a manner the director reasonably believes to be in the best interests of the nonprofit corporation.” MODEL NONPROFIT CORP. ACT § 8.30(a)(2) (2008).

22. See MARION R. FREMONT-SMITH, GOVERNING NONPROFIT ORGANIZATIONS: FEDERAL AND STATE LAW AND REGULATION 428 (2004). While some scholars dispute the separate obligation of obedience, I have previously argued for it. See Sugin, *supra* note 7.

23. See Evelyn Brody, *The Legal Framework for Nonprofit Organizations*, in THE NONPROFIT SECTOR: A RESEARCH HANDBOOK 243, 244 (Walter W. Powell & Richard Steinberg eds., 2d ed. 2006) (“[I]t is not easy to say what ‘the law’ is in the nonprofit sector.”).

24. The number of public charities registered with the IRS increased 42% from 2000 through 2010, to almost a million organizations. Blackwood, Roeger & Pettijohn, *supra* note 3, at 2. In 2010, the entire nonprofit sector—which includes private and public charities, small organizations not required to register, religious organizations, and other noncharitable nonprofits—exceeded 2.3 million organizations. See *id.* at 1-2, 4.

25. See John D. Colombo, *Commercial Activity and Charitable Tax Exemption*, 44 WM. & MARY L. REV. 487, 489 (2002) (“[I]t is now common to find charities engaged in numerous economic activities through a variety of business arrangements including subsidiary corporations, joint ventures, and contractual agreements.”).

26. Brody, *supra* note 23, at 243.

every state.²⁷ The AG's burden is great because very few other parties are allowed to bring suit to enforce these duties.²⁸ AG charities offices are underfunded and understaffed, and they have not grown at the rate of the sector itself.²⁹ Consequently, deliberate malfeasance by charity insiders can often proceed undetected by AGs. At the same time, well-meaning directors receive little guidance and assistance from the AGs in carrying out their obligations. Honest trustees often lack the knowledge and judgment necessary to carry out their legal obligations of careful attention³⁰ and fidelity³¹ to the organizations that they serve. In many states, there is virtually no easily accessible information to guide fiduciaries in their roles.³² To confuse things further for charity directors and state regulators, the IRS has encroached on the states' traditional role in overseeing nonprofit governance, even though it may not have the legal authority to preempt the states' traditional functions and despite its questionable suitability for the task.³³

B. *Legal Enforcement of Fiduciary Duties Is Minimal*

The lack of law stems from both the dearth of decided cases that specifically involve charities and the scarcity of specific rules and standards applicable to charities in many states. Some states have no unique charity law at all, creating the impression either that charities are somehow beyond the law or that there is nothing unique about the law of charities compared to the law of other institutions.³⁴ While the

27. See Gano, *supra* note 12, at 1, 14-15.

28. In addition to the AG, directors have standing to bring suit for violations of fiduciary duties, but beneficiaries and donors generally do not. See Rob Atkinson, *Unsettled Standing: Who (Else) Should Enforce the Duties of Charitable Fiduciaries?* 23 J. CORP. L. 655 (1998). Many fiduciary duty cases are dismissed for lack of standing. See *infra* note 46 and accompanying text.

29. See FREMONT-SMITH, *supra* note 22, at 445.

30. See *id.* at 199-205 (defining the duty of care as including paying attention to the corporation's affairs).

31. See Sugin, *supra* note 7, at 902 (describing the duty of obedience as a "more abstract fiduciary duty" of fidelity).

32. See *infra* note 164 and accompanying text.

33. See James J. Fishman, *Stealth Preemption: The IRS's Nonprofit Corporate Governance Initiative*, 29 VA. TAX REV. 545 (2010); Lloyd Hitoshi Mayer & Brendan M. Wilson, *Regulating Charities in the Twenty-First Century: An Institutional Choice Analysis*, 85 CHI.-KENT L. REV. 479 (2010); Marcus S. Owens, *Charities and Governance: Is the IRS Subject to Challenge?*, 60 EXEMPT ORG. TAX REV. 287 (2008), available at <http://www.lexisnexis.com/hottopic/lnacademic/> (select "Advanced Options"; type "Tax Analysts Exempt Organization Tax Review Magazine" into the "Source" section; then search for "Charities and Governance: Is the IRS Subject to Challenge").

34. Sophisticated lawyers would advise New York charities to incorporate in Delaware because it has no separate law. See Jenkins, *supra* note 5.

law of charities overlaps with the law of trusts and the law of business corporations, there are unique characteristics of charitable organizations that demand specific law. Those characteristics were apparent to the drafters of the 1601 Statute of Charitable Uses, and the increasing complexity of charities' structures and operations today makes legal rules even more important now.

Published opinions concerning the fiduciary duties of individuals who control nonprofit organizations are few, and cases holding directors liable for breach are scarce. While directors have obligations of loyalty, care, and (maybe) obedience,³⁵ states enforcing fiduciary duties concentrate on the duty of loyalty, which demands that fiduciaries refrain from using their positions to improperly obtain personal benefits.³⁶ The emphasis on loyalty is not surprising given that violations of loyalty are the clearest example of charity abuse. Courts have found the duty breached when there is clear self-dealing by the director that enriches the director at the expense of the charity.³⁷ In some cases, large monetary penalties have been imposed on the breaching parties and awarded to the organization.³⁸ These penalties punish the wrongdoer, make the organization whole, and serve as a warning to future directors not to engage in self-dealing.

Occasionally, an organization may be dissolved for self-dealing.³⁹ Though a dramatic remedy, dissolution may be desirable where there is no public purpose or charitable activities to be preserved by keeping the organization alive. In the most egregious fraud cases, individuals may create an organization for nothing but self-enrichment, so the purpose of the organization is not really charitable at all, but exists

35. See Sugin, *supra* note 7, at 896-904 (discussing the duty of obedience as a “the stepchild to the duties of care and loyalty within the nonprofit cannon”).

36. See JAMES J. FISHMAN & STEPHEN SCHWARZ, *NONPROFIT ORGANIZATIONS: CASES AND MATERIALS* 163 (4th ed. 2010).

37. See *Bos. Children’s Heart Found., Inc. v. Nadal-Ginard*, 73 F.3d 429 (1st Cir. 1996); *State ex rel. Little People’s Child Dev. Ctr., Inc. v. Little People’s Child Dev. Ctr., Inc.*, No. M2007-00345-COA-R3-CV, 2009 WL 103509 (Tenn. Ct. App. Jan. 9, 2009); *Summers v. Cherokee Children & Family Servs., Inc.*, 112 S.W.3d 486 (Tenn. Ct. App. 2002); *Marist Coll. v. Nicklin*, No. 01-94-00849-CV, 1995 WL 241710 (Tex. App. Apr. 27, 1995); *John v. John*, 450 N.W.2d 795 (Wis. Ct. App. 1989).

38. See *Bos. Children’s*, 73 F.3d at 431, 443 (awarding judgments in favor of Boston Children’s Heart Foundation for \$6,562,283.02); *Little People’s*, 2009 WL 103509, at *11 (awarding judgment against defendants for \$1,782,666.00); *Marist Coll.*, 1995 WL 241710, at *2 (awarding the college a total of \$19,825.22, with \$8,189.76 coming from the defendant, Nicklin, directly); see also *John*, 450 N.W.2d at 797-98 (enjoining an officer from serving as the organization’s director in the future and requiring them to pay a monetary sum of \$1,171,418.00 plus interest).

39. See *Summers*, 112 S.W.3d at 531.

only to siphon funds from the charitable sector into private hands. The Coalition Against Breast Cancer, which managed to raise substantial sums from donors, is a good example. It was “a sham charity that ha[d] diverted nearly all of the millions of dollars raised in the name of breast cancer to its officers, directors and fundraisers.”⁴⁰ In its complaint, the New York AG demanded the organization’s dissolution.⁴¹

Despite these examples, director liability is unusual, and in cases involving breach of care alone, it is exceptional.⁴² Care is more likely to be enforced if it is accompanied by a breach of loyalty than if it constitutes gross negligence with inchoate consequences for the organization.⁴³ The combination care-loyalty pattern is predictable, and the harm from failure to exercise care is more concrete where it is an accessory to a loyalty breach—a powerful insider steals from an organization (loyalty) and the directors charged with monitoring him are not paying attention (care), so the charity’s losses are undetected, prolonged, and/or large. If an organization has any directors who were not involved in the self-dealing that occurred, they presumably failed in their oversight role. But it is unusual for the negligent directors, who enjoyed no personal financial benefits from the wrongdoing, to be personally liable for the losses. New York’s settlement with Educational Housing Services (EHS) and its directors is a recent example of this combination: while the founder siphoned money from the organization, the rest of the directors failed to stop him.⁴⁴ The EHS

40. Gary Snyder, *This Breast Cancer Fraud Has It All*, NONPROFIT IMPERATIVE (July 21, 2011), <http://nonprofitimperative.blogspot.com/2011/07/this-breast-cancer-fraud-has-it-all.html>.

41. *Complaint*, State v. Coal. Against Breast Cancer, Inc. (No. 20432-2011), <http://www.ag.ny.gov/sites/default/files/press-releases/2011/Summons%20and%20Complaint.pdf>.

42. Because care violations are often alleged coincident with loyalty violations, it is often hard to differentiate the remedies for each. Monetary liability for a care violation alone is rare, though there are a few cases. See, e.g., *Lifespan Corp. v. New Eng. Med. Ctr., Inc.*, No. 06-cv-421-JNL, 2011 WL 2134286 (D.R.I. May 24, 2011) (awarding a \$272,756 judgment for care violation); *Lynch v. John M. Redfield Found.*, 88 Cal. Rptr. 86 (Ct. App. 1970); *In re Estate of Donner*, 626 N.E.2d 922 (N.Y. 1993) (finding a trustee guilty of a care violation).

43. See *Aramony v. United Way of Am.*, 28 F. Supp. 2d 147 (S.D.N.Y. 1998) (finding breaches of both care and loyalty and entering judgments against directors); *Stern v. Lucy Webb Hayes Nat’l Training Sch. for Deaconesses & Missionaries*, 381 F. Supp. 1003 (D.D.C. 1974) (same); *Macaluso v. Jenkins*, 420 N.E.2d 251 (Ill. App. Ct. 1981) (resolving a suit against a nonprofit director on the theory of corporate veil piercing without addressing the director’s fiduciary responsibilities of loyalty and care); *John*, 450 N.W.2d 795 (finding breaches of both care and loyalty and entering judgments against directors).

44. *Assurance of Discontinuance*, N.Y. ATT’Y GEN. 1-5 (Dec. 5, 2012), http://www.ag.ny.gov/pdfs/EHS_AOD.pdf.

case is unusual because the negligent directors agreed to pay \$850,000 in damages for their breach of fiduciary duties to the organization, even though they had not financially benefitted.⁴⁵

Notwithstanding some enforcement successes at the administrative stage or in litigation, individual plaintiffs generally lose in charity fiduciary duties actions. Because AGs are the only party with undisputed standing to sue, courts commonly dismiss fiduciary breach cases for lack of standing.⁴⁶ Where plaintiffs are permitted to proceed, some courts have concluded that the defendant owed no fiduciary duty to the plaintiffs, based on an analysis of the relationship between the parties in the dispute.⁴⁷ Other cases hold that the directors have acted within the appropriate bounds of their fiduciary duties,⁴⁸ which are broad because the “best judgment rule” protects nonprofit managers from liability for mistakes in judgment if they act in good faith, with sufficient care, and without conflicts of interest.⁴⁹ Even where plaintiffs prevail, the remedies for gross negligence may be weak: in a leading care case, the court ordered future trustees of an organization to read his opinion explaining why the directors involved in the case were grossly negligent in carrying out their obligations.⁵⁰

45. See *id.* at 7.

46. See, e.g., *Wisdom v. Centerville Fire Dist., Inc.*, 391 F. App'x 580 (9th Cir. 2010); *Kidwell ex rel. Penfold v. Meikle*, 597 F.2d 1273 (9th Cir. 1979); *Askew v. Trs. of the Gen. Assembly of the Church of the Lord Jesus Christ of the Apostolic Faith, Inc.*, 644 F. Supp. 2d 584 (E.D. Pa. 2009); *Koch v. Ironwood Country Club*, No. E030460, 2002 WL 1965466 (Cal. Ct. App. Aug. 26, 2002); *George Pepperdine Found. v. Pepperdine*, 271 P.2d 600 (Cal. Dist. Ct. App. 1954); *O'Donnell v. Sardegna*, 646 A.2d 398 (Md. 1994); *Grand Council of Ohio v. Owens*, 620 N.E.2d 234 (Ohio Ct. App. 1993); *Lundberg v. Lascelles*, No. 59178-9-I, 2007 WL 4157779 (Wash. Ct. App. Nov. 26, 2007).

47. The relationship between the parties is analyzed and found to be one not requiring fiduciary duties. See *Paul v. Judicial Watch, Inc.*, 543 F. Supp. 2d 1 (D.D.C. 2008); *Olson v. Auto. Club of S. Cal.*, No. B201428, 2009 WL 1039573 (Cal. Ct. App. Apr. 20, 2009); *Fine Iron Works v. La. World Exposition, Inc.*, 472 So. 2d 201 (La. App. 4 Cir. 1985); *State ex rel. Boone v. Sundquist*, 884 S.W.2d 438 (Tenn. 1994).

48. See *S. Bay Rod & Gun Club v. Dashiell*, No. D053658, 2009 WL 4547032 (Cal. Ct. App. Dec. 4, 2009); *Murrell v. Crocker*, No. B190152, 2007 WL 1839478 (Cal. Ct. App. June 28, 2007); *In re Northridge Earthquake Commercial Litig. (Farmers Grp.)*, No. B170128, 2004 WL 1832970 (Cal. Ct. App. Aug. 17, 2004); *White v. Bd. of Dirs. of St. Elizabeth Baptist Church*, 42,903-CA (La. App. 2 Cir. 1/9/08); 974 So. 2d 164; *Consumers Union of U.S., Inc. v. State*, 840 N.E.2d 68 (N.Y. 2005).

49. See FISHMAN & SCHWARZ, *supra* note 36, at 152-53. The best judgment rule is the nonprofit corollary to the business judgment rule in corporate law.

50. The order reads:

Ordered that each present trustee of Sibley Memorial Hospital and each future trustee selected during the next five years shall, within two weeks of this Order or promptly after election to the Board, read this Order and the attached Memorandum Opinion and shall signify in writing or by notation in the minutes of a Board meeting that he or she has done so

While the judge was innovative, as a punishment for wrongdoing, the remedy was undeniably pathetic. At best, enforcement of charity fiduciary duties is exceedingly modest, and few cases produce useful lessons for fiduciaries to follow.

C. Can Business Law Fill the Gap in Charities Fiduciary Law?

One possible solution to the problem of too little law for nonprofit organizations could be to borrow the law from business organizations. It is common for the law of nonprofit organizations to look to its for-profit counterpart as a model, and the statutory standards for loyalty and care in nonprofit corporations mirror the standards for business corporations.⁵¹ Businesses and nonprofits share the same kinds of agency cost problems—managers of both might be tempted to steal from the organization or to shirk their responsibilities. Good governance in both contexts depends on keeping greed and sloth at bay.

But there is not much to borrow. Fiduciary duties in business organizations are hardly enforced by regulators at all. Since corporate shareholders can bring derivative suits against directors, courts have had an opportunity to consider more claims for breach of care against directors of businesses than against nonprofits. Nevertheless, in the business corporation context—like for nonprofits—the duty of care is almost never enforced by a court.⁵² Some corporate law scholars seem to be satisfied with the lack of legal enforcement of care.⁵³ Edward Rock and Michael Wachter describe the corporation as “self-governing” and argue that if courts intervened regularly in questions of negligence, centralized management could not function.⁵⁴ Centralized management is necessary in nonprofit organizations as well as in business corporations because decisions must be made and

Stern v. Lucy Webb Hayes Nat'l Training Sch. for Deaconesses & Missionaries, 381 F. Supp. 1003, 1021 (D.D.C. 1974).

51. See MODEL BUS. CORP. ACT (2007); MODEL NONPROFIT CORP. ACT (2008).

52. See Joy v. North, 692 F.2d 880 (2d Cir. 1982) (explaining the business judgment rule and rare liability for corporate directors); Aronson v. Lewis, 473 A.2d 805 (Del. 1984) (discussing care but not imposing any liability for its breach); *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106 (Del. Ch. 2009); *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996). The most famous case imposing liability for lack of care, *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985), led to an upheaval in the legal community before the adoption of the liability shield in DEL. CODE tit. 8, § 102(b)(7) (2014). See generally Roundtable Discussion: *Corporate Governance*, 77 CHL.-KENT L. REV. 235 (2001).

53. See Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619, 1699 (2001).

54. *Id.*

implemented, so we might conclude, by analogy, that we should leave nonprofits alone to self-govern also.

Keeping courts out of questions of negligence in nonprofit governance would reduce the role of the state. But given the press's and the public's interest in nonprofit governance (and scandals), media oversight of nonprofit governance would continue regardless of the state's choice.⁵⁵ The "self-governing" nonprofit organization would be subject to internal controls and media scrutiny. Abstention by the state would increase the importance of the media's role and its method of shaming charities leaders into good behavior. Would that be preferable to a larger state role? David Skeel argues, in the business context, that shaming of corporate directors is a particularly good approach to enforcing care violations because monetary liability is inappropriate where the directors did not personally benefit from their fiduciary failures.⁵⁶ The problem with ill-fitting judicial remedies is common to breaches of care in both the for-profit and nonprofit context, so shaming might be a better remedy for both. Skeel notes that there has been judicial shaming in the business context by the Delaware courts.⁵⁷ In addition to front-page newspaper embarrassment, official shaming is an option in the nonprofit sector as well; the AG could publish lists of negligent directors and their organizations.⁵⁸ But an official shaming remedy would require the same kind of enforcement costs as other official remedies—the state would need to undertake investigations and prosecutions in getting to that result. The beauty of a shaming regime is that the press can do it without the participation of the state so the AG can direct its attention to other issues.⁵⁹

Another alternative to active enforcement modeled on business law is increased disclosure. The most significant recent developments in nonprofit law have related to disclosure.⁶⁰ Disclosure may make

55. See discussion *infra* Part III (discussing media shaming in more detail).

56. See David A. Skeel, Jr., *Shaming in Corporate Law*, 149 U. PA. L. REV. 1811, 1854 (2001) (discussing the *Caremark* case).

57. *Id.* at 1855 n.178 (noting that courts have lectured corporate directors in their opinions).

58. Charities bureaus already do engage in a shaming activity by publishing statistics about fund-raisers' share of money raised on behalf of charities. See, e.g., "Pennies for Charity"—*The Attorney General's Report on Fundraisers in New York*, CHARITIESNYS.COM, http://www.charitiesnys.com/pennies_report_new.jsp (last visited Mar. 1, 2015). For better or for worse, the media is a more effective purveyor of shame because it gets more readers.

59. See *infra* notes 98-104 and accompanying text.

60. See Evelyn Brody, *Sunshine and Shadows on Charity Governance: Public Disclosure as a Regulatory Tool*, 12 FLA. TAX REV. 183 (2012); Dana Brakman Reiser, *There Ought To Be a Law: The Disclosure Focus of Recent Legislative Proposals for Nonprofit Reform*, 80 CHI.-KENT L. REV. 559 (2005).

organizations more internally self-regulating by relying on both reputational incentives and fear of enforcement. If an organization must disclose what it is doing, it is more likely to try to do everything right. It is also more likely that the authorities will discover wrongdoing, making it easier for them to enforce appropriate fiduciary duties. Disclosure has long been a feature of the federal law applicable to public corporations,⁶¹ although the nature and breadth of disclosure requirements differ substantially for businesses and charities.⁶² IRS Form 990, the informational return that tax-exempt organizations must file with the federal government, was recently revised to increase the governance disclosure it requires.⁶³ The form asks organizations to explicitly state, for example, whether they have a written conflict-of-interest policy, whistle-blower policy, and document-retention policy.⁶⁴ Although the form states that these are policies not required by the tax law,⁶⁵ anyone completing the form gets the clear message that the correct answer to these questions is “yes.” These filings are provided to the government, but it may be more significant that they are readily available online,⁶⁶ so that the public reputation of an organization is at stake in these answers. Some commentators have been skeptical about the value of increased disclosure requirements as a self-enforcement mechanism for the nonprofit sector, particularly given the costs to the sector of disclosure itself.⁶⁷ The link between disclosure and governance improvement may simply be too weak for increased public

61. Reiser, *supra* note 60, at 570 n.52. Companies with more than \$10 million in assets whose securities are held by more than 500 owners must file reports. Reports are publicly available. See *EDGAR*, SEC, <http://sec.gov/edgar/searchedgar/webusers.htm#> (last visited Mar. 1, 2015).

62. There are many more 990s filed than 10-K reports, and while the precise content of the disclosed information differs, both forms require financial information and governance information. See *Form 10-K*, SEC, <http://www.sec.gov/about/forms/form10-k.pdf> (last visited Mar. 1, 2015); *Form 990*, IRS 6 (2014), <http://www.irs.gov/pub/irs-pdf/f990.pdf>. Though small charities do not have to file lengthy reports, small and private businesses are not subject to the federal requirements. See *Instructions for Form 990-EZ*, IRS 1 (Dec. 23, 2014), <http://www.irs.gov/pub/irs-pdf/i990ez.pdf>; *Form 10-K*, SEC, <http://www.sec.gov/answers/form10k.htm> (last visited Mar. 1, 2015).

63. See *2011 Form 990 and 990-EZ—Significant Changes*, IRS (May 18, 2012), http://www.irs.gov/pub/irs-tege/2011_form_990_significant_changes.pdf.

64. *Form 990*, *supra* note 62, at 6.

65. *Id.*

66. GUIDESTAR, <http://www.guidestar.org> (last visited Mar. 1, 2015).

67. See Ellen P. Aprill, *What Critiques of Sarbanes-Oxley Can Teach About Regulation of Nonprofit Governance*, 76 *FORDHAM L. REV.* 765 (2007); Brody, *supra* note 60; Dana Brakman Reiser, *Enron.org: Why Sarbanes-Oxley Will Not Ensure Comprehensive Nonprofit Accountability*, 38 *U.C. DAVIS L. REV.* 205 (2004); Reiser, *supra* note 60.

disclosure to be worth its cost, and it is impossible to know how much “self-governance” that disclosure actually produces.

Disclosure may be a more desirable solution in the business context than in the nonprofit context. The key factor that makes disclosure powerful in business law—and allows courts to reasonably stay out of negligence questions—is markets. Courts do not need to enforce the duty of care, not because business corporations are actually “self-governing,” but because the market for corporate control monitors corporate governance.⁶⁸ Business directors and executives ignore the fiduciary standards of conduct at their peril. But nonprofit directors need not fear a market monitor. In the charities context, there is no parallel market that functions as a market for control because nonprofits do not have shareholders who can sell control.⁶⁹ There are no proxy contests or even director elections. Nonprofit boards are self-perpetuating: current directors recruit their cohorts and successors.⁷⁰

The market in which nonprofits operate is a market for charitable donations, government contracts, and volunteer services. It is possible that these markets impose some governance constraints; an organization that does no good is likely to eventually wither from lack of support. But these markets are not efficient, so they are unlikely to be nearly as powerful as the market for control in the business context. Henry Hansmann’s explanation for why nonprofits exist—“contract failure”—would suggest that donors, beneficiaries, and volunteers would be slow to recognize a nonprofit’s failure to carry out its mission.⁷¹ Lack of information is a crucial component of “contract failure,” which Hansmann defines as “the inability to police producers by ordinary contractual devices.”⁷² For example, donors who finance charitable services for others cannot be sure that the services are actually being provided because they cannot see the services themselves. Hansmann explains that the nonprofit form of

68. See Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 113 (1965). This is the classic story anyway, which has been refined, critiqued, and tested in the corporate law literature, but is beyond the scope of this Article.

69. But see Dana Brakman Reiser, *Nonprofit Takeovers: Regulating the Market for Mission Control*, 2006 BYU L. REV. 1181 (analyzing changes in control and direction of nonprofit organizations and comparing them to corporate takeovers).

70. See FISHMAN & SCHWARZ, *supra* note 36, at 127 (stating that organizations without members have no constituents that behave like shareholders, so their governing boards choose their successors).

71. See Henry B. Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835, 845 (1980).

72. *Id.*

organization exists to overcome this problem.⁷³ The nondistribution constraint that characterizes nonprofits substitutes for a working market: donors may not be able to confirm that an organization's managers used their money the way the organization promised, but at least they know that managers did not put it in their pockets. None of these nonprofit constituencies have as powerful a force at their disposal as that of the corporate takeover market.⁷⁴ Donors can withhold their funds, volunteers can withhold their services, and governments can withhold their contracts, but with self-perpetuating boards, their effect on governance is limited. So the business corporation model of self-enforcement seems ill-suited to nonprofits. The duty of care may be enforced by an invisible hand for public companies, but it is nonetheless enforced. To the contrary, fiduciary duties of nonprofit organizations either need to be enforced by the state or left to the media's enforcement. The next Part considers the latter option.

III. MEDIA OVERSIGHT OF CHARITIES GOVERNANCE

A. *Media Enforcement Is Robust Because Reputation Matters to Nonprofit Leaders*

Stories of charities abuses have long been popular with newspapers,⁷⁵ and the growth of the internet has allowed more charities watchdogs to arise.⁷⁶ Thus, despite its lack of legal status, the media has become a crucial player in the story of charities regulation. Underenforcement of fiduciary duties by AGs and courts does not mean that nonprofit fiduciaries escape condemnation for their wrongdoing. Instead, individuals who control charities are more likely to be censured in the court of public opinion than in a court of law.

Individuals who benefit personally at the expense of the organizations they serve are prime targets for the press because their stories can be quite sensational. A front-page story in the *New York Times* about Cecilia Chang, a dean at St. John's University who killed herself while being tried for stealing more than a million dollars from

73. See *id.* at 859-61.

74. Cf. David M. Schizer, *Subsidizing Charitable Contributions: Incentives, Information, and the Private Pursuit of Public Goals*, 62 TAX L. REV. 221 (2009) (arguing for greater monitoring of nonprofits by donors).

75. The United Way story was uncovered by the *Washington Post*. See Harvey J. Goldschmid, *The Fiduciary Duties of Nonprofit Directors and Officers: Paradoxes, Problems, and Proposed Reforms*, 23 J. CORP. L. 631, 633 (1998).

76. See sources cited *supra* note 9.

the university and its donors, was both bizarre and violent.⁷⁷ While the legal authorities were criminally prosecuting Chang, news stories were able to drag in other individuals who may not have been criminally culpable. For example, the *Times* reported that the university's president, the Reverend Donald Harrington, accepted a Patek Philippe watch and custom suits from Chang's supporters.⁷⁸ Although a less lurid part of the story, the allegations are troubling from the perspective of Harrington's fiduciary duties. Regardless of whether the state ever proceeds against him, the news reports were certainly embarrassing and damaging to his reputation.⁷⁹ By looking at the university's leadership, the *Times's* story played a crucial role in investigating and punishing governance lapses by those in charge.

Media shaming also embarrasses organizations, in addition to individuals associated with them, tarnishing their charitable halos. Lance Armstrong's disgraceful fall from hero-athlete to dooper cast a dark shadow over his immensely popular cancer charity, Livestrong. A front-page newspaper story, published after Armstrong admitted doping, accused the organization's leadership of breaches of loyalty: "While Mr. Armstrong's celebrity fed the charity, the charity also enhanced his marketability. Livestrong also engaged in some deals that appeared to have benefited him and his associates, according to interviews and financial records."⁸⁰ The report alleged that Armstrong used the charity as part of his defense to the doping accusations.⁸¹ These claims suggest troubling governance breaches at the charity because they imply that the individuals used the charity for personal ends and that those in control failed to prevent Armstrong from tainting its charitable mission. Whether or not breaches actually occurred, a major newspaper's allegations are sufficient to inflict substantial damage on a charity's standing in the community and its leaders' reputations.⁸²

77. See William K. Rashbaum, Wendy Ruderman & Mosi Secret, *Fallen Dean's Life, Contradictory to Its Grisly End*, N.Y. TIMES (Dec. 10, 2012), <http://www.nytimes.com/2012/12/11/nyregion/a-quick-descent-for-cecilia-chang-dean-at-st-johns.html?pagewanted=all&r=0>.

78. See *id.*

79. See *id.*

80. Stephanie Saul, *Armstrong's Business Brand, Bound Tight with His Charity*, N.Y. TIMES (Jan. 13, 2013), <http://www.nytimes.com/2013/01/14/sports/cycling/lance-armstrongs-business-brand-and-livestrong-are-bound-together.html?pagewanted=all>.

81. See *id.*

82. The story also mentions that the charity "hired top lawyers with nonprofit expertise to make sure its deals were in its best interests and complied with I.R.S. rules." See *id.*

Lapses in the duty of care, which requires attention and deliberative process in decision making,⁸³ might seem less sensational than stealing and other loyalty breaches, but they can also appeal to a curious public, which will quickly censure. The story of Brandeis University's botched attempt to close its Rose Art Museum and sell the art to ameliorate its dire financial troubles was featured prominently in the press,⁸⁴ even though the problem was mismanagement rather than theft.⁸⁵ Facing undeniable financial troubles, the Brandeis University Board of Trustees voted to close its campus art museum and sell the collection without discussing the issue with the museum's leadership, its supporters, or Brandeis's own fine arts faculty and students.⁸⁶ The *Boston Globe* immediately picked up the story,⁸⁷ and the *New York Times* followed soon thereafter with both a news story⁸⁸ and a scathing editorial criticizing the decision.⁸⁹ Ultimately, the university backed down and reversed course, but not before the Massachusetts AG commenced an investigation and museum supporters commenced a lawsuit.⁹⁰ Brandeis's President Jehuda Reinharz resigned two days after an internal report on the Rose crisis was issued, though he

83. See FREMONT-SMITH, *supra* note 22, at 201-05.

84. See Randy Kennedy & Carol Vogel, *Outcry over a Plan To Sell Museum's Holdings*, N.Y. TIMES (Jan. 27, 2009), <http://www.nytimes.com/2009/01/28/arts/design/28rose.html>; Lisa Kocian, *Students Rally for Brandeis Museum: Loss Will Hurt School Stature, Protestors Say*, BOS. GLOBE (Jan. 30, 2009), available at <https://a.next.westlaw.com> (search for "2009 WLNR 1775207").

85. See Linda Sugin, *Lifting the Museum's Burden from the Backs of the University: Should the Art Collection Be Treated as Part of the Endowment?*, 44 NEW ENG. L. REV. 541, 566-68 (2010) (arguing that the Rose problem was gross negligence—a problem of lack of due care because of the manner in which the university reached the decision and not because the substance of the decision was beyond the powers of the university); see also Paul Dillon, *The Rose Art Museum Crisis*, NEW DIRECTION FOR HIGHER EDUC., Fall 2010, at 83 (arguing that the incident illustrated the complexities in university decision making and control and was exacerbated by Brandeis's organizational culture).

86. See Geoff Edgers, *Ailing Brandeis Will Shut Museum, Sell Treasured Art: No Other Choice, Says President*, BOS. GLOBE (Jan. 27, 2009), available at <http://a.next.westlaw.com> (search for "2009 WLNR 1536251").

87. See Geoff Edgers & Peter Schworm, *Brandeis To Sell School's Art Collection*, BOS. GLOBE (Jan. 26, 2009), http://www.boston.com/ae/theater_arts/articles/2009/01/26/brandeis_to_sell_schools_art_collection/.

88. See *Brandeis Says It Plans To Sell Art Collection To Raise Cash*, N.Y. TIMES (Jan. 26, 2009), <http://www.nytimes.com/2009/01/27/us/27museum.html>; Kennedy & Vogel, *supra* note 84.

89. "Selling the university's art collection would help plug its financial gap, but it would create a gaping hole in Brandeis's mission and its reputation." Editorial, *Art at Brandeis*, N.Y. TIMES (Feb. 1, 2009), <http://www.nytimes.com/2009/02/02/opinion/02mon4.html>. The editorial implied a breach of the duty of obedience. See *id.*

90. See Sugin, *supra* note 85, at 543.

claimed the decision was not motivated by the Rose fiasco.⁹¹ An honest and well-meaning director might have gone along with the decision on the Rose, in the face of other equally unpleasant solutions.

When AGs get involved, they are often followers to the media, as was the case in the Brandeis fiasco. An investigation of improprieties at the Getty Trust by the California AG's office followed an exposé in the *Los Angeles Times* and led to state oversight of the trust for a period of years.⁹² The *Boston Globe* first revealed financial abuses at the Cabot Trust,⁹³ and then the Massachusetts authorities followed up and provided for restitution to the charity.⁹⁴ State authorities cannot be blamed for following the press—it is undoubtedly an efficient strategy for regulators because they waste little time identifying the problems.⁹⁵ But it is nonetheless troubling that the media leads in this way because its leadership in overseeing nonprofit organizations reduces the role of law and weakens the charitable sector. There is less need for official action when the remedies the law might provide have already been meted out or have been rendered moot: a damning story can destroy an organization by drying up donations.

The immense power of reputation explains how the media has so successfully displaced legal authorities in charities enforcement. The benefits of charity participation are often reputational—your name on a building, status in the community, and/or honors and awards from local institutions. These accoutrements of charity leadership are all tied to status in the community, and reputational incentives have long

91. Dillon, *supra* note 85, at 88.

92. See Bill Lockyer, *Report on the Office of the Attorney General's Investigation of the J. Paul Getty Trust*, CAL. ATT'Y GEN., https://oag.ca.gov/system/files/attachments/press_releases/06-085_0a.pdf (last visited Mar. 1, 2015) (“The Office of the Attorney General’s Charitable Trusts Section in July 2005 initiated a civil investigation of the Trust. The probe was launched following a series of articles in the *Los Angeles Times* . . .” (footnote omitted)). There was no finding of criminal wrongdoing in the Getty Trust investigation, so the investigation solely concerned governance lapses. See *id.* at 1 n.1.

93. *Some Officers of Charities Steer Assets to Selves*, BOS. GLOBE (Oct. 9, 2003), http://www.boston.com/news/nation/articles/2003/10/09/some_officers_of_charities_steer_as_sets_to_selves/?page=full. Most notoriously, Paul Cabot, the trustee, increased his salary from the trust to \$1.4 million in one year to cover the cost of his daughter’s wedding. *Id.*

94. See Sacha Pfeiffer & Michael Rezendes, *Mass., 2 Other States To Probe Foundations*, BOS. GLOBE (Oct 10, 2003), http://www.boston.com/news/local/massachusetts/articles/2003/10/10/mass_2_other_states_to_probe_foundations/?page=full; Walter V. Robinson & Michael Rezendes, *Foundation Chief Agrees To Repay over \$4M*, BOS. GLOBE (Dec. 16, 2004), <https://a.next.westlaw.com> (search for “2004 WLNR 14185894”).

95. States also depend on whistle-blowers and individuals with knowledge of improprieties and access to information. See, e.g., *Charitable Organization Complaint Form*, MASS.GOV, https://www.eform.ago.state.ma.us/ago_eforms/forms/char_ecomplaint.action (last visited Mar. 1, 2015).

functioned as self-monitoring devices for charity leaders. These reputational incentives for good performance are consistent with a commitment to the mission. Almost all trustees volunteer their time and expertise,⁹⁶ suggesting that charities directors generally accept their roles out of nonpecuniary dedication to their organizations. Studies show that nonprofit employees accept less compensation, support, and infrastructure at their jobs than their for-profit counterparts, signaling their mission commitment.⁹⁷ Reputational incentives for charity leaders are aligned with mission commitment because the reputation of an organization and its leaders converge. While reputation is a self-enforcing mechanism that encourages many individuals to act with self-sacrifice for the common good, it is also a tool that the media powerfully and purposely wields.

B. The Good and Bad of Media Enforcement

The most compelling arguments in favor of media enforcement—and the shaming sanctions that accompany it—are that it is effective and cheap. Media participation in nonprofit oversight allows state AGs to devote their scarce resources elsewhere, which might produce greater overall benefits for both the sector and society. Given the community of upstanding people who generally serve as charities fiduciaries, media shaming should be perceived as a serious punishment. Even if the wrongdoer is shameless, so that the reputational penalty is ineffective as to him, the collateral effects on other charity leaders could justify the approach. Most charitable fiduciaries are respected members of the community and care to remain that way, so shaming may be well-targeted to be effective with the intended group. Media enforcement can raise standards of governance throughout the sector by spreading fear of humiliation and thereby deterring bad behavior.

According to Marion Fremont-Smith and Andras Kosaras's compendium of newspaper reports, most cases described in newspaper stories on charity wrongdoing also involve a government enforcement

96. See KURTZ, *supra* note 21, at 6. Directors do not work full time for an organization. Nonprofit executives who do work full time receive compensation, which is one of the most controversial issues in nonprofit governance today. See S. 7565, 2012 Gen. Assemb., Reg. Sess. (N.Y. 2012) (prohibiting salaries for directors of public charities and instituting standards for reasonableness of executive compensation).

97. See Peter Frumkin & Elizabeth K. Keating, *The Price of Doing Good: Executive Compensation in Nonprofit Organizations* 8 (Hauser Ctr. for Nonprofit Orgs., Working Paper No. 8, 2001), available at http://papers.ssrn.com/sol/papers.cfm?abstract_id=292253 (citing studies).

party at some point.⁹⁸ However, there are some cases in which no government agencies were involved and the “case” was overseen entirely by the press, sometimes with impressive results. The *Dallas Morning News* reported that the Kimbell Art Foundation overpaid its president and vice president.⁹⁹ Even though there was no government action to recover excess benefits, the individuals agreed to forego future compensation—an impressive remedy.¹⁰⁰ The *San Diego Union Tribune* reported that the executive director of the San Diego Museum of Art was alleged to have received excessive compensation, and financial controls were implemented at the organization without governmental intervention.¹⁰¹ In other cases, the charity took the matter into its own hands after press reports, which is also a desirable outcome from a good-governance perspective. For example, in the case of the Giving Back Fund, the charity sued the self-dealing director and settled the case, and in the case of the Communities Foundation of Texas, the charity investigated itself and implemented internal controls.¹⁰² On the other hand, there are press stories followed by no remedial action, such as in the case of the National Foundation for AIDS Relief, which also involved allegations of excessive compensation reported in the press.¹⁰³ Thus, not all media enforcement produces governance improvement.

The press has a long history of monitoring abuses in the nonprofit sector, so it is experienced in this role, which is another argument in its favor. Perhaps the most famous nonprofit abuse—the United Way scandal involving William Aramony—was exposed by the *Washington Post* in 1992.¹⁰⁴ And we might believe that media enforcement is more effective today than it was twenty years ago

98. Marion R. Fremont-Smith & Andras Kosaras, *Wrongdoing by Officers and Directors of Charities: A Survey of Press Reports 1995-2002*, 42 EXEMPT ORG. TAX REV. 25 (2003), available at <http://www.lexisnexis.com/hottopics/lnacademic> (select “Advanced Options”; type “Tax Analysts Exempt Organization Tax Review Magazine” into the “Source” section; then search for “wrongdoing by officers and directors of charities”; select the first result).

99. *Id.* at 54 & n.29.

100. *Id.* at 54.

101. *Id.* at 56 & n.46.

102. *Id.* at 52.

103. *Id.* at 55.

104. Charles E. Shepard, *Perks, Privileges and Power in a Nonprofit World; Head of United Way America Praised, Criticized for Running It Like a Fortune 500 Company*, WASH. POST, Feb. 16, 1992, available at <http://library.tulane.edu/> (search for “perks, privileges and power in a nonprofit world”; select “Articles”; follow first “check TULink” hyperlink; follow “full text online” hyperlink for Factiva database). Reports of William Aramony’s behavior had been uncovered in “several publications.” Teltsch, *supra* note 10.

because it is more sustained and focused. There are a number of reputable organizations that hold themselves out as charity watchdogs, reporting on the activities and decisions of organizations.¹⁰⁵

In spite of these reasons to be enthusiastic about media enforcement, there are more reasons to be skeptical. “The majority of publishers, editors and reporters contend that the primary role of journalism is to expose wrongdoing.”¹⁰⁶ This is a problem from the perspective of media enforcement of legal obligations for a few reasons. The press may be too zealous in looking for abuses where none exist or in identifying something ambiguous as wrongdoing. The press may prove itself too enthusiastic an enforcer, able to indict without following through on evidence to convict and to bury vindication where few readers tread.¹⁰⁷ While the state, because it is subject to the rule of law, may not be arbitrary and capricious in its legal decisions, the press is not bound by the same standard. There is no required fair process for media accusations or a requirement for proportionality. If the press’s role is to expose wrongdoing, then scandals get reported while successes do not. Even where the press gets the facts right—which it often does—this imbalance is problematic for the charitable sector because it creates the impression of more wrongdoing as a percentage of the whole than is accurate. The sector as a whole suffers when the bad is the only story and the good is ignored.

The media attention to a particular scandal might not reflect the seriousness of any legal violations but might instead reflect the public interest in a celebrity¹⁰⁸ or a well-known institution. A small scandal involving a well-known individual is likely to get more press attention than a larger one that is less sensational. Under the law of some states,

105. See sources cited *supra* note 9.

106. David Bornstein, *Why ‘Solutions Journalism’ Matters, Too*, N.Y. TIMES OPINIONATOR (Dec. 20, 2011, 8:48 PM), <http://opinionator.blogs.nytimes.com/2011/12/20/why-solutions-journalism-matters-too/> (citing DAVID L. PROTESS ET AL., *THE JOURNALISM OF OUTRAGE: INVESTIGATIVE REPORTING AND AGENDA BUILDING IN AMERICA* 14 (1991)).

107. By the time a determination of no wrongdoing is concluded, the public humiliation has already occurred. If you blinked, or failed to get to page thirteen, you would have missed the clearing of General John Allen in the Tampa socialite scandal. See Thom Shanker, *Pentagon Clears Commander over E-Mails*, N.Y. TIMES (Jan. 22, 2013), <http://www.nytimes.com/2013/01/23/us/pentagon-clears-general-allen-over-e-mails-with-socialite.html>.

108. See Deborah Sontag & Stephanie Strom, *Star’s Candidacy in Haiti Puts Focus on Charity*, N.Y. TIMES (Aug. 16, 2010), <http://www.nytimes.com/2010/08/17/world/americas/17haiti.html> (detailing allegations and problems with hip-hop star Wyclef Jean’s postearthquake Haiti charity).

the legal punishment allowed for care violations can be limited,¹⁰⁹ but the press may shame regardless of the statute. The press is in a position to embarrass everyone, whether they did something evil, clueless, or harmless. Its enforcement is insensitive to fine legal distinctions, meting out a uniform punishment of public embarrassment. Even more than legal authorities, who may have trouble with remedies,¹¹⁰ media enforcement cannot tailor remedies to suit particular problems.

The current crisis in the newspaper business might mean less careful enforcement than should be acceptable as a substitute for legal action. Newspapers are traditionally concerned about their own reputations, so readers are confident in the reliability of their reporting. But the newspaper industry has suffered a severe blow in the last decade.¹¹¹ In their struggle to survive, some newspapers have sacrificed in ways that reduce confidence in both their integrity and their ability to report accurately. Hundreds of journalists have been fired. While we cannot blame newspapers for responding to their own industry's pressures, we need to recognize that the changes might make them less reliable monitors of fiduciary behavior. It may be unfair to expect that newspapers can afford to carry the burden of law enforcement.

The ubiquity and permanence of information on the Internet also raises concern about the media's reliability for nonprofit enforcement. Not only are there more watchdogs than there were a decade or two ago, but their accusations are increasingly easy to find and more accessible to more individuals. It is cheaper to be a media watchdog today than it once was, which has led to a proliferation of oversight, both reliable and questionable. Along with the many reputable websites run by organizations committed to defined standards, there are also individuals who have self-selected as monitors of charity

109. Organizations can include a provision in their certificate of incorporation limiting remedies for breach of care to nonfinancial penalties. DEL CODE tit. 8, § 102(b)(7) (2014) (allowing the inclusion in a certificate of incorporation of a "provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director"); *see also* MODEL NONPROFIT CORP. ACT § 8.31 (2008) (describing liability standards for directors).

110. *See supra* note 50 and accompanying text.

111. *See* JACK FULLER, WHAT IS HAPPENING TO NEWS: THE INFORMATION EXPLOSION AND THE CRISIS IN JOURNALISM (2010); Marion R. Fremont-Smith, *Can Nonprofits Save Journalism?: Legal Constraints and Opportunities*, JOAN SHORENSTEIN CENTER ON PRESS, POL., PUB. POL'Y (Oct. 2009), http://shorensteincenter.org/wp-content/uploads/2012/03/can_nonprofits_save_journalism_fremont-smith.pdf.

behavior.¹¹² A Google search will reveal their accusations as readily as those of more careful institutions. More troubling is the fact that any accusation of misbehavior, whether ultimately proved true or not, is permanently in the searchable history of an individual or group. The Internet broadens the range of embarrassment to a wider, more geographically dispersed audience. Every future employer, client, and blind date will know that an individual was involved in something embarrassing related to a charity. Reputational taints are more permanent today than they were when the daily newspaper was discarded at the end of the day, so we should be more careful about imposing reputational costs on people.

The public may have unrealistically high expectations for charity officials. There is interest in the indiscretions of charities leaders because there is a widely held expectation that those who serve charities are better than the rest of us. “Although we have come to expect a certain amount of lying, cheating, and stealing in the private and public sectors, in the court of public opinion, the nonprofit sector, and especially charities, are held to a higher standard.”¹¹³ The halo effect of charities extends to all who are associated with them, and evidence that individuals are lowly humans is sometimes treated as scandalous. In William Aramony’s obituary, readers were reminded about his extramarital affair with a girl just out of high school.¹¹⁴ There was nothing criminal about the affair in itself—she was not a child—and yet, it seemed that his position as a major charity leader was inconsistent with his sex life.¹¹⁵ He siphoned money from the United Way for her, but more broadly for himself, which was the illegal part; but reading the obituary, you might think the legal problem involved sex rather than money.¹¹⁶ Even donors to charities are more scrutinized than others who engage in the same type of behavior. Consider Alberto Vilar, who was convicted of defrauding a client out of \$5

112. Are you familiar with DON’T TELL THE DONOR.ORG, <http://donttelltthedonor.blogspot.com> (last visited Mar. 1, 2015); NONPROFITEER, <http://nonprofiteer.net> (last visited Mar. 1, 2015); or NONPROFIT BOARD CRISIS, <http://www.nonprofitboardcrisis.typepad.com> (last visited Mar. 1, 2015)? It is hard to know whom to trust.

113. BARBARA KELLERMAN, *BAD LEADERSHIP: WHAT IT IS, HOW IT HAPPENS, WHY IT MATTERS* 165 (2004).

114. See Robert D. McFadden, *William Aramony, United Way Leader Who Was Jailed for Fraud, Dies at 84*, N.Y. TIMES (Nov. 13, 2011), <http://www.nytimes.com/2011/11/14/business/william-aramony-disgraced-leader-of-united-way-dies-at-84.html>; *William Aramony Dead at 84*, THE NONPROFIT TIMES (Dec. 1, 2011), <http://www.thenonprofittimes.com/news-articles/william-aramony-dead-at-84/>.

115. See *William Aramony Dead at 84*, *supra* note 114.

116. See *id.*

million and sentenced to nine years in jail.¹¹⁷ His crimes have received much more attention than similar crimes of others because he was a well-known philanthropist and his misappropriations might have been connected to gifts he made to the Metropolitan Opera.¹¹⁸

Public approbation can arise if there is a suggestion of impropriety, even where it is not clear that any legal wrongdoing actually occurred. Some people believe that charity executives should accept less compensation than they would have received for similar work in the private sector. The press is perennially interested in nonprofit-executive compensation, even when there is no claim of impropriety connected to it,¹¹⁹ and charity executives are unable to keep their salaries private because IRS Form 990 requires disclosure.¹²⁰ The New York State Board of Regents' overhaul of Adelphi University's board was partly about its president's compensation of \$837,113 (including retirement benefits and in-kind perks) in 1995-96.¹²¹ That was very high at the time for a college president, but was it so high as to be an obvious waste of university resources? The same year, Florida State University paid its football coach more than \$1 million.¹²² Many of the well-known governance scandals involve compensation and perks,¹²³ even though the determination of reasonable compensation under the law is difficult and inexact.¹²⁴ Under federal law, the section

117. There was a lengthy profile of him in *The New Yorker*. See James B. Stewart, *The Opera Lover; Onward and Upward with the Arts*, NEW YORKER (Feb. 13, 2006), <http://newyorker.com/magazine/2006/02/13/the-opera-lover>.

118. See Stewart, *supra* note 117.

119. The *New York Times* reports on college presidents annually. See, e.g., Tamar Lewin, *Three Dozen Private-College Presidents Earned over \$1 Million in 2010, Study Finds*, N.Y. TIMES (Dec. 9, 2012), <http://www.nytimes.com/2012/12/10/education/three-dozen-private-college-presidents-earned-over-1-million-in-2010.html>; Tamar Lewin, *Private-College Presidents Getting Higher Salaries*, N.Y. TIMES (Dec. 4, 2011), <http://www.nytimes.com/2011/12/05/education/increase-in-pay-for-presidents-at-private-colleges.html>.

120. See *Form 990*, *supra* note 62, at 7-8 (requiring information about the compensation of officers, directors, trustees, key employees, and the five highest compensated employees). This is much more disclosure than is required of business organizations. See *Form 10-K*, *supra* note 62.

121. See Meyer, *supra* note 20.

122. Bobby Bowden was the first college coach to break the \$1 million mark, but now that is common. See Michael Sanserino, *College Coaches' Salaries Continue To Soar*, PITTSBURGH POST-GAZETTE (Jan. 15, 2011, 12:00 AM), <http://www.post-gazette.com/news/nation/2011/01/15/College-coaches-salaries-continue-to-soar/stories/201101150179>.

123. For example, Barry Munitz, of the Getty Trust, enjoyed excessive perks but did not siphon funds from the charity. See Lockyer, *supra* note 92, at 2-3.

124. For a good discussion of reasonable compensation and I.R.C. § 4958 (2012), see Jill S. Manny, *Nonprofit Payments to Insiders and Outsiders: Is the Sky the Limit?*, 76 FORDHAM L. REV. 735 (2007).

4958 regulations¹²⁵ take an arm's-length comparative approach to compensation, expressly allowing comparison with for-profit compensation for similar jobs,¹²⁶ even though that might appear excessive to people who are committed to lower relative salaries in the nonprofit sector.¹²⁷ The standard for excessive compensation in the federal tax regulations does not always coincide with the expectations that people have about what is a fair pay package for nonprofit executives, and compensation has increased even after the adoption of the federal rules.¹²⁸ Public outrage over salaries is not always rational or justified.

The media operates with little check on its judgment because there are no "norm entrepreneurs"¹²⁹ in nonprofit governance who use the media but are more reliable watchdogs than the journalists themselves. I am thinking of the model of Robert Monks and Nell Minow, who have been effective in fostering improved corporate governance by publicizing inadequate behavior in the media. Monks and Minow are in the business of advising shareholders for institutional investors. On one occasion, they placed a full page ad in the *Wall Street Journal* accusing the directors of the Sears Corporation of being "non-performing assets," and within a short time, the directors changed their behavior.¹³⁰ Monks and Minow are effective nongovernmental watchdogs due to a combination of factors that are mostly inapposite in the nonprofit context. First, their clients (and consequently their business) stand to gain or lose on account of their

125. I.R.C. § 4958 imposes an excise tax on excess benefit transactions, which include excessive compensation of individuals in positions of control in the organization.

126. The rebuttable presumption of reasonableness in Treas. Reg. § 53.4958-6(c)(2) (2012) requires that the organization use appropriate comparability data for compensation. The regulation states, "In the case of compensation, relevant information includes, but is not limited to, compensation levels paid by similarly situated organizations, both taxable and tax-exempt, for functionally comparable positions . . ." *Id.*

127. A proposed New York law takes a narrower approach:
Compensation exchanged by a not-for-profit corporation for the performance of services by an executive must not be excessive and the governing body (i.e., the board of directors, board of trustees, or equivalent controlling body) shall consider factors including, but not limited to: compensation levels paid by similarly situated not-for-profit corporations as defined in section one hundred two of this chapter; the availability of similar services in the geographic area of the applicable provider of services; current compensation surveys compiled by independent firms; and actual written offers from similar institutions competing for the services of the applicable executive.
S. 7565, 2012 Gen. Assemb., Reg. Sess. (N.Y. 2012) (proposing to add section 727 to the New York Not-for-Profit Corporation Law, although this was not adopted).

128. See Manny, *supra* note 124, at 735-37.

129. See Skeel, *supra* note 56, at 1859.

130. See *id.* at 1826, 1846, 1848.

actions, so they have capital and goodwill at stake when they accuse boards of bad performance. Their successes in corporate governance reforms translate into profits for their clients and for themselves. Second, their actions come at significant cost to themselves—their Sears board ad cost over \$100,000.¹³¹ Third, they have credibility on account of their experience and their personal investment in the cause; Monks was once a bank president, and he has used his personal resources to fund his ventures.¹³² Without established norm entrepreneurs with stakes in the outcome of nonprofit governance, the arbiters of reputation for nonprofit actors are the media itself, who lack the incentives and constraints that norm entrepreneurs face.

Media oversight might not be as effective in deterring bad behavior as one might hope, and too much media attention to nonprofit abuses may backfire and reduce overall social welfare. In the criminal context, scholars have argued that too much shaming can reduce public interest in the bad behavior and consequently fail to produce the intended deterrence; the public may become accustomed to the negative publicity and stop noticing it.¹³³ That would be a problem in the charitable context as well, undermining the effectiveness of media oversight without governance improvements. The opposite effect from media overload is also troubling in the charitable context: too many stories of charity abuse can undermine the public's trust in the charitable sector as a whole and the public's commitment to support it.

Sometimes bad leaders bring fundamentally good organizations down with them, an unfortunate by-product of public shaming of fiduciaries. Charitable institutions are more vulnerable to the effects of public ignominy than are for-profit corporations because the loss of donations can have an immediate, devastating effect on charitable services; charitable donors are not equivalent to washing machine purchasers, who may buy a good product even if it is produced by a company with bad governance.¹³⁴ Hale House, one of the “most

131. *See id.* at 1826 n.56.

132. *See id.* at 1859.

133. *See* Toni M. Massaro, *Shame, Culture, and American Criminal Law*, 89 MICH. L. REV. 1880, 1930-31 (1991).

134. The stock price may reflect bad press, but the price of the stock in the market may not have any immediate effect on the underlying operations of the business. Charitable organizations with large endowments may weather volatility in donations better than others, but many organizations have no endowment on which to rely.

famous charities in the world” in 1985,¹³⁵ never fully recovered from its 2001 scandal, which involved the theft of millions of dollars by the organization’s president (and founder’s daughter).¹³⁶ While it is impossible to know whether the organization could have recovered from the abuses if it had sufficient funds, the donating public did not give it that chance. Hale House continues to exist today, but it is a shadow of its former self. Business shaming strategies may encourage better corporate governance,¹³⁷ but charity shaming strategies are unlikely to produce net benefits to the charitable sector because the immediate deleterious effect on donations is likely to be more harmful than the long-term salutary effects on governance improvements.

There has been a lively debate in the criminal law literature about shaming as a criminal sanction. While media shaming of nonprofits is not quite analogous, the criminal law debate may shed some light on the general desirability of a shaming strategy. Proponents of shaming argue that it is an effective and efficient alternative to other criminal penalties, and opponents argue that shaming disrespects individuals and is not ultimately successful as a deterrent.¹³⁸ As we consider the remedy of public embarrassment for negligent charity governance, it is helpful to note that the weight of opinion in that literature seems to have turned decidedly against shaming, with Dan Kahan, an early champion,¹³⁹ explicitly recanting.¹⁴⁰ The reasons are many, but those who are willing to countenance shaming in the criminal context are dubious about the conditions under which it would take place in our society.¹⁴¹ We generally operate in a community that is too big for effective shaming sanctions, which demand reintegration after shaming. Misgivings among criminal law scholars should make

135. Kathryn Jean Lopez, *Scandal at Hale House: Sifting Through the Rubble of a Once-Proud Nonprofit*, PHILANTHROPY ROUNDTABLE (Aug./Sept. 2001), http://www.philanthropyroundtable.org/topic/excellence_in_philanthropy/scandal_at_hale_house.

136. See Heidi Evans, *Hale House Shuts Doors to Orphans*, N.Y. DAILY NEWS (Oct. 8, 2008, 6:58 PM), <http://www.nydailynews.com/new-york/hale-house-shuts-doors-orphans-article-1.303533>; Lopez, *supra* note 135. In 2008, Hale House substantially scaled back its program, still suffering from reduced funds. See Evans, *supra*.

137. See Jayne W. Barnard, *Reintegrative Shaming in Corporate Sentencing*, 72 S. CAL. L. REV. 959 (1999) (arguing that corporate directors should be required to be present at the criminal sentencing of the corporation).

138. See Note, *Shame, Stigma, and Crime: Evaluating the Efficacy of Shaming Sanctions in Criminal Law*, 116 HARV. L. REV. 2186 (2003).

139. See Dan M. Kahan, *What Do Alternative Sanctions Mean?*, 63 U. CHI. L. REV. 591 (1996).

140. See Dan M. Kahan, *What’s Really Wrong with Shaming Sanctions*, 84 TEX. L. REV. 2075 (2006).

141. See Massaro, *supra* note 133, at 1917-35.

charities officials wary about embracing reputational sanctions to foster better nonprofit governance.

In addition, there are important distinctions between criminal law shaming and enforcing fiduciary duties through public embarrassment that make the strategy even less attractive in the latter context. First, the criminal law literature evaluates shaming as opposed to incarceration,¹⁴² while incarceration is not the model in fiduciary duty enforcement. In governance, the alternative is some greater governmental participation along a wide spectrum of enforcement that might include regulation, disclosure, liability, and/or advisory procedures like the ones advocated here. Rehabilitation in this context is about fostering good decision-making practices, and as long as there are alternatives to shaming that might achieve that goal better than public humiliation, they should be pursued. Second, the criminal law literature assumed that shaming would be imposed by a governmental institution so that a court might require a convicted drunk driver to publicize that fact in a bumper sticker or the state might publish a list of the clients of prostitutes.¹⁴³ Reputational punishments for inadequate charity governance meted out by the press are wholly outside the law. For all these reasons, enforcement by humiliation is bad policy that undermines the rule of law, even if it is effective in improving charity governance.

If we are dissatisfied with the role of the press and believe that the corporate model of self-enforcement ill suits nonprofits, greater government involvement by the state will be necessary. Media attention is unlikely to wane, and increased media regulation is unlikely to be desirable or pass muster under the First Amendment. The government needs to do more to reset the balance. States must make and develop law, something the media is institutionally unable to do. They also need to be the neutral arbiter of good charity governance, applying the law in an evenhanded and accountable way, without concern for celebrity and sensationalism, a neutrality that the media cannot guarantee.

Charity officials have lost ground, and that is troubling because state charity bureaus, unlike the journalists and bloggers, are concerned with the legal standards and with protecting the charitable sector and its resources. The primary reason why states should

142. See Dan Markel, *Wrong Turns on the Road to Alternative Sanctions: Reflections on the Future of Shaming Punishments and Restorative Justice*, 85 TEX. L. REV. 1385 (2007).

143. See Dan M. Kahan & Eric A. Posner, *Shaming White-Collar Criminals: A Proposal for Reform of the Federal Sentencing Guidelines*, 42 J.L. & ECON. 365, 367 (1999).

respond to the challenge of private enforcers is because there is no guarantee that the private enforcers care to, or are in a position to, maximize public benefit. State AGs cannot be passive observers of media enforcement; if the state chooses to underenforce fiduciary obligations, it is choosing to allow private parties to manage that enforcement instead. The increasing power and influence of media enforcers need to be countered with greater activity by state AGs. We must recognize that the problem is not only that bad things are happening without legal consequences, but that legal institutions are failing to prevent those things from happening before they do. Given media attention, the confidentiality paradox, and the scarcity of legal guidance, states should consider shifting some of their focus to better facilitating good governance.

IV. A PROPOSAL FOR ADVANCE RULINGS

Charity governance needs more focused attention and more expert decision making by nonprofit fiduciaries. Unfortunately, current institutions are not designed to promote these objectives. Too much attention has been focused on *ex post* enforcement after wrongdoing has occurred, rather than *ex ante* intervention to prevent wrongdoing. The tools used by AGs and courts are not designed to raise the quality of governance decisions because they are backward-looking: both state regulators and courts exercise their power to order financial restitution—an appropriate remedy in cases of loyalty breaches—but this is rarely a cure for the problems of insufficient care or obedience.¹⁴⁴ Financial restitution is only apt where a fiduciary breach is clearly connected to a past loss of charitable funds. The remedy in the *Sibley Hospital* case—a judicially imposed education for directors in their governance obligations¹⁴⁵—attempted to address the source of the problem identified by the court. The remedy did not actually cure the failure to exercise care that had previously taken place, but it did hone in on the nature of the breach. At the same time, the remedy was weak as an enforcement sanction. So, even though it was designed to suit the problem, it seems insufficient in the *ex post* context.

There are substantial roadblocks to increasing *ex post* enforcement of fiduciary duties. Resources are a primary one. The

144. See *supra* note 45 and accompanying text.

145. See *Stern v. Lucy Webb Hayes Nat'l Training Sch. for Deaconesses & Missionaries*, 381 F. Supp. 1003, 1021 (D.D.C. 1974).

perennial problem of scarce state enforcement resources has understandably beggared charitable governance; many AGs focus their limited attention on the problems of fraud, leaving governance for the sector to manage.¹⁴⁶ But the best use of scarce public resources needs to be evaluated more broadly, considering the context of the social benefits of the charitable sector as a whole. It is a mistake to focus solely on the budgetary costs to state AG offices in determining whether it is worthwhile to invest in charity governance. The larger social costs of poor governance need to be factored in as well. Solutions should value overall efficiencies so that the costs to charities, as well as to government, are considered. These charity costs include the difficulty of attracting good directors, litigation costs incurred whether governance practices are vindicated or not, and public faith in the integrity of the sector. States and individual organizations should both be willing to make investments that can prevent greater public and charity costs in the future.

Increasing disclosure has been one strategy.¹⁴⁷ Although disclosure might generate greater enforcement opportunities, state resources have not enabled AGs to mine the disclosures the way they might. States could capitalize on disclosure by allowing others to bring enforcement actions; nonprofits could mimic the shareholder derivative action. Similarly, states could promote judicial enforcement of trustee fiduciary obligations by expanding the rules for standing to donors (and others) and thereby allow private parties to assist the state in enforcement. Though some scholars have advocated broader standing rules,¹⁴⁸ more plaintiffs would mean more harassment and expense for nonprofit organizations, with questionable governance benefits to offset those costs.

Another option to increase enforcement would be to pare back the “best judgment rule,” which protects the exercise of judgment by trustees who act in good faith and without conflicts of interest.¹⁴⁹ But it

146. Judging from their websites, many states focus their attention specifically on solicitation fraud. *About Charities*, IN.GOV, <http://www.in.gov/attorneygeneral/2382.htm> (last visited Mar. 7, 2015); *Charities*, MICH. ATT’Y GEN., <http://www.michigan.gov/ag/0,4534,7-164-17337-18095---,00.html> (last visited Mar. 1, 2015).

147. See Brody, *supra* note 60; Reiser, *supra* note 60.

148. See, e.g., Iris J. Goodwin, *Donor Standing To Enforce Charitable Gifts: Civil Society vs. Donor Empowerment*, 58 VAND. L. REV. 1093, 1101 (2005) (“[D]onors whose restricted gifts are crucial to the vitality and diversity of the charitable sector should have standing to enforce those gifts . . .”).

149. The “best judgment rule” is the nonprofit corporation corollary of the business judgment rule for business corporations. It empowers directors to make bad decisions

would be unwise to abrogate the best judgment rule because it strikes an important balance in the law. The rule is essential in the nonprofit sector to enable organizations to attract directors and, more importantly, to maintain the private character of charity governance.¹⁵⁰ Judicial micromanagement of charity governance is unlikely to produce net benefits for the charitable sector, and any judicial solution could require changing core elements of nonprofit law. A less dramatic solution to governance lapses would be preferable.

Creative, forward-looking action better fits the problems connected with care and obedience (and even sometimes loyalty) than any kind of after-the-fact enforcement. Even though it is underdeveloped in legal precedent and underenforced by state authorities, lawyers advising charities believe that the duty of care is authentic and that the minimum standard of charity oversight requires fiduciaries to pay attention and gather information.¹⁵¹ Charities need to hew to their mission, even though there is little particular guidance that teaches them how.¹⁵²

We need to focus on the *goals* of greater enforcement for fiduciary duties. Care technically requires process,¹⁵³ but that process is always a proxy for improved substance. Care demands deliberation and information gathering in the hope that the substantive decisions that boards reach are better.¹⁵⁴ But process is not always a good substitute for a correct answer on the merits, and some studies indicate that imposing some forms of “good” process do not necessarily improve substantive outcomes.¹⁵⁵

For these reasons, I propose a formal advance-ruling procedure under which state AGs provide advice to nonprofit fiduciaries on

without being second-guessed by courts. See FISHMAN & SCHWARZ, *supra* note 36, at 152-53.

150. See generally Evelyn Brody & John Tyler, *How Public Is Private Philanthropy?: Separating Reality from Myth*, PHILANTHROPY ROUNDTABLE (2012), http://www.philanthropyroundtable.org/file_uploads/How_Public_Is_Private_Philanthropy.pdf.

151. See Goldschmid, *supra* note 75, at 632 (describing law as “aspirational”).

152. See Sugin, *supra* note 7, at 925-27.

153. “The members of the board of directors . . . , when becoming informed in connection with their decision-making function or devoting attention to their oversight function, must discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances.” MODEL NONPROFIT CORP. ACT § 8.30(b) (2008).

154. See FREMONT-SMITH, *supra* note 22, at 201-05.

155. For example, independent boards might not produce better governance. See Kathleen M. Boozang, *Does an Independent Board Improve Nonprofit Corporate Governance?* (Seton Hall Univ. Sch. of Law Legal Studies Research Paper Series, Paper No. 1002421, 2007) available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1002421.

specific fiduciary decisions. Such a process would be particularly valuable for care questions, because—as I have argued—there is no adequate way to repair care after a breach. An advance-ruling process could also extend to loyalty¹⁵⁶ and obedience questions; the dilemmas posed in the introduction to this Article raise all three kinds of issues. Advance rulings could be a more effective and efficient use of state resources than other approaches to improved enforcement, like disclosure and broader standing rules. Recall that a central problem with fiduciary duties of nonprofit directors is that there is so little legal authority on even the most fundamental issues that nonprofit fiduciaries regularly find themselves facing.¹⁵⁷ There are too many questions for which there are no definitive answers, and the states should try to fill that gap by issuing guidance that fiduciaries—and their lawyers—can use to guide their behavior.

The ruling process could resemble the private letter ruling process at the IRS.¹⁵⁸ A charity would have to follow procedures determined by the state and have a question that the AG is willing to rule on. The ruling request would need to set out both the legal questions presented and the facts to which the law should be applied.¹⁵⁹ In the tax context, the question is often: will this transaction be taxable? In the charities context, the question will often be: will these actions satisfy the board's fiduciary obligations? While the AG might be able to answer with a short yes or no, even a minimal application of the law to the facts would be helpful to other boards with similar problems. In selected cases, the AG might choose to write a longer “opinion” analyzing an important question of law.

Like private letter rulings, these advance rulings would not have precedential effect or become binding on the state in other cases, but they would provide guidance to the charity requesting the letter¹⁶⁰ and establish a body of decisions that advisors could use in understanding the contours of charity fiduciary law. After some time, for example,

156. Loyalty questions often turn into process questions because the statutory safe harbor provisions that apply to conflict-of-interest transactions consist of cleansing processes. See N.Y. NOT-FOR-PROFIT CORP. LAW § 715 (2014). I am grateful to Caroline Gentile for this point.

157. See discussion *supra* Part II.A.

158. See Rev. Proc. 2012-1, 2012-1 I.R.B. 1-91. The provision of advice by regulators is not unique to the IRS. The Securities and Exchange Commission also provides advice—even answering questions by telephone. See *Manual of Publicly Available Telephone Interpretations*, SEC, <http://www.sec.gov/interp/telephone.shtml> (last modified Feb. 2, 2007).

159. See Rev. Proc. 2012-1, 2012-1 I.R.B. at 18-30.

160. See *id.* at 50-53.

we would get a sense of what constitutes adequate, minimum participation necessary for a board member to satisfy her duties and the kinds of deliberations and disclosures that would satisfy the statutory procedures for review of conflict transactions¹⁶¹ (as well as the nature of the conflicts transactions that are acceptable). Because fiduciary duties are broad, general guidance (even if not binding on the government) is helpful.

As a first step toward building a useful body of law, I would challenge state AGs to redact and publish the settlements they have entered into that have been kept secret. There may currently be a large body of guidance that charities could use if it were made available to them. State AGs could follow the IRS ruling model of confidentiality by protecting the identity of an organization but disclosing its issues. In the versions publicly available under the Freedom of Information Act (and regularly published), IRS letters provide sufficient facts for subsequent actors to measure their similarity to the requesting party, but not so much that applicants are outed in the process.

My proposal for an advance-ruling process takes advantage of some of the unique characteristics of charities. While there is admittedly deliberate wrongdoing in the charitable sector, public policies should capitalize on the general perception that charitable fiduciaries are devoted to the missions of their organizations and volunteer to participate as a way to do good in the community. My proposal builds on their good intentions and honest efforts, while recognizing that there is a limit to their time, attention, and good judgment. Will Rogers is claimed to have said, “Good judgment comes from experience, and a lot of that comes from bad judgment.”¹⁶² The problem for fiduciaries is that there is no room for the bad judgment to come first, so good judgment needs to come from something other than experience. The queasy feeling that a lawyer may have when presented with a transaction between an organization and one of its directors may not raise any red flags for a well-meaning fellow director who is ignorant of the law and busy with other concerns.

The specter of public embarrassment that nonprofit fiduciaries face when they err is likely to be sufficient to encourage them to take extra steps to avoid mistakes—as long as the cost of avoidance is not too high. The risk of making a bad mistake might be small, the risk of

161. See MODEL NONPROFIT CORP. ACT § 8.60 (2008).

162. *Will Rogers Legacy: Remembering That Old Cowboy*, CA.GOV, http://www.parks.ca.gov/?page_id=23998 (last visited Mar. 1, 2015).

being found out is even smaller, and the risk of being legally sanctioned is virtually nonexistent, but the risk of being embarrassed in the community could be substantial. Trustees can be expected to make a cost-benefit analysis of any *ex ante* mechanisms that can prevent future missteps.

The New York AG is on the right track with its new Directors U initiative, which offers instruction in good governance to nonprofit directors.¹⁶³ Some states include guidelines for good practices on their websites, but visits to the AG websites of all fifty states have revealed how little is available to guide the well-meaning but confused charity fiduciary.¹⁶⁴ Many states are more focused on fundraising and the important issues of solicitation fraud and donor protection than on charity governance, *per se*. Training charitable fiduciaries to understand their obligations and preparing them to manage problems they might face could greatly improve the quality of charity governance.¹⁶⁵ However, I am skeptical about how many individuals will volunteer to undergo training if they are not legally required to do so under a statute.¹⁶⁶ Board meetings and charity functions are already an imposition on the time of volunteer board members who have jobs, families, and other obligations. People do not necessarily recognize that they could use training until they have a problem they cannot solve, and, even then, they are likely to be more concerned with a specific solution to that problem than with general standards of behavior that might not shed light on the particular case.

An advance-ruling process makes financial sense for both states and charities. An important feature of tax private letter rulings are the

163. See *A.G. Schneiderman Announces Bold Plan To Revitalize and Reform New York's Nonprofit Sector*, N.Y. ATT'Y GEN. (Feb. 16, 2012), <http://www.ag.ny.gov/press-release/ag-schneiderman-announces-bold-plan-revitalize-and-reform-new-yorks-nonprofit-sector>.

164. Visits to the AG websites of all fifty states revealed that some sites were not searchable (Alabama, Idaho, and Wyoming) and others had no information on charities (e.g., Mississippi, Nebraska, and West Virginia). The vast majority had very little information for charities and were primarily directed toward donor protection. Only a few states had a substantial amount of helpful information for charity fiduciaries (California, Massachusetts, and New York). Research compilation of state AG websites is on file with author.

165. New York is way ahead of the pack in offering both training and attorney-matching services to nonprofits. This is an initiative with the New York City Bar Association. See *City Bar Justice Center's Public Service Network Places 1,000th Volunteer*, N.Y.C. BAR (Oct. 20, 2010), <http://www2.nycbar.org/citybarjusticecenter/news-a-media/press-releases/122-city-bar-justice-centers-public-service-network-places-1000th-volunteer-lawyer>.

166. S. 7565, 2012 Gen. Assemb., Reg. Sess. (N.Y. 2012) (proposing the addition of section 116 to the New York Not-for-Profit Corporation Law), provides that nonprofit corporations contracting with the state may attend state consortium training free of charge, but does not require them to do so.

fees that requesting parties must pay.¹⁶⁷ For strapped charities bureaus, fees paid by requesting parties can finance all or part of the project. The IRS charges more for more complex rulings and reduces fees for small taxpayers; charities bureaus could follow the same pattern and have sliding fees based on resources and complexity. It would often be in the best interest of a charity to pay a modest fee and request AG advice because a ruling would not only foreclose state enforcement vis-à-vis the requesting charity, but would also protect that organization from private litigation on the issue, a real advantage for the organization. The IRS requires that requesting parties draft what is essentially a legal brief and submit it as part of the ruling request. This reduces costs for the government in researching the issue and identifying relevant authority, and the model is attractive in this context also. Depending on the issue, some types of charity requests might be prepared without the assistance of a lawyer; the charities bureau could design a model form for certain types of ruling requests that moderately competent directors could complete. One example might be a series of questions related to satisfaction of the safe harbor for independent review of conflict-of-interest transactions. It could inquire as to the nature of the conflict disclosed, the nature of the transaction, and the process undertaken by the organization to determine the transaction's fairness.¹⁶⁸

Early intervention by the AG can prevent later needs for enforcement, so the total commitment of resources by the state might not be so much higher than it is today. Consider the example of the Rose Art Museum again. The university's unilateral announcement was followed quickly by litigation that continued despite intervention by the state. The Massachusetts AG was involved in the resolution of the problem but was too late to prevent the incident from becoming a fiasco for Brandeis and its president. The matter was not finally closed until the private litigation settled quite a while later.¹⁶⁹ Earlier involvement by the AG that forestalls private actions would benefit charities like Brandeis by reducing the costs of potential missteps. The resources that go into disputes with private parties are a precious loss to the charitable sector, often with no offsetting benefit. Even where

167. See I.R.C. § 7528 (2012); Rev. Proc. 2012-1, 2012-1 I.R.B. 55-61, 68-72; Rev. Proc. 2012-8, 2012-1 I.R.B. 235.

168. Different states have different statutes for cleansing conflicted transactions, but these are the common elements. See N.Y. NOT-FOR-PROFIT CORP. LAW § 715 (2014).

169. Brandeis announced the settlement with the plaintiffs and the termination of the AG's investigation on June 30, 2011. See *Brandeis, Plaintiffs Settle Rose Art Museum Lawsuit*, BRANDEIS NOW (June 30, 2011), <http://www.brandeis.edu/now/2011/june/rose.html>.

challengers are denied standing to challenge the charity's actions,¹⁷⁰ defending the action is a drain of charitable resources. It would be worth extra investment in the charities bureaus to prevent the massive expenses incurred in litigation.

This proposal is not designed to foil purposeful wrongdoers. Nor would it help to solve the problem of completely clueless charity fiduciaries. Accordingly, an advance-ruling process would not preempt the need for all state enforcement of fiduciary obligations. Instead, the process is intended for well-meaning, busy, and somewhat ignorant directors—which is likely to be the vast majority. They need to know that they can turn to the AG for guidance, but they do not need to know much about the substance of their obligations before they do. This is an important advantage of the proposal because it is often easier to recognize that you have a problem than it is to determine the solution. Requesting a ruling on a unique question seems more realistic than expecting charity fiduciaries to suddenly embrace their legal responsibilities with sustained attention and enthusiasm.

In the aggregate, an advance-ruling process has the potential to improve nonprofit governance throughout the sector by creating more law. Because the AG will be guiding the contours, the proposal allows the states to reclaim control over fiduciary duty law. While there will likely be a high demand for rulings at first, as more guidance becomes available, the need for further rulings should decline, reducing the cost to both charities and government. The goal of the system is to create a body of law robust and varied enough that individual charities will not, in fact, need to request their own rulings unless they have unique issues.

V. CONCLUSION

We are in an unfortunate bind in the world of charity law. If an organization resolves an issue with the AG's office, the entire procedure is likely to stay confidential. That is good for the organization involved because it suffers none of the reputational harm that public disclosure—and embarrassing press—brings. But for the

170. A surprising number of published opinions conclude that plaintiffs lack standing to sue. See *Wisdom v. Centerville Fire Dist., Inc.*, 391 F. App'x 580 (9th Cir. 2010); *Kidwell ex rel. Penfold v. Meikle*, 597 F.2d 1273 (9th Cir. 1979); *Askew v. Trs. of the Gen. Assembly of the Church of the Lord Jesus Christ of the Apostolic Faith, Inc.*, 644 F. Supp. 2d 584 (E.D. Pa. 2009); *George Pepperdine Found. v. Pepperdine*, 271 P.2d 600 (Cal. Dist. Ct. App. 1954); *O'Donnell v. Sardegna*, 646 A.2d 398 (Md. 1994); *Grand Council of Ohio v. Owens*, 620 N.E.2d 234 (Ohio Ct. App. 1993); *Lundberg v. Lascelles*, No. 59178-9-I, 2007 WL 4157779 (Wash. Ct. App. Nov. 26, 2007).

charitable community as a whole, that resolution is mixed. It is good that organizations reform their activities to better carry out the goals of the charitable sector. But it is unfortunate that there is so little application of the law for charities to look to in measuring their own compliance.

I know that the popular mantra both in and out of the nonprofit world is transparency. But transparency is sometimes overrated. Disclosure is desirable when it encourages individuals to comply with the liability standards of the law and boosts a higher aspirational standard of behavior.¹⁷¹ Transparency is not helpful where daylight threatens the mission and public support for organizations experiencing governance challenges. The public interest is served when state regulators intervene as a problem develops at an organization and design solutions with the organization that prevent debacles.

Once the media has reported a problem, a constructive remedy is unlikely. The shaming effects on individuals and organizations involved are already part of the permanent and easily accessed record. The only solution that really addresses the problem of media shaming that protects charities and prevents mistakes made by fiduciaries is one that precedes widespread publicity. The AG's office needs to be involved earlier, and its role needs to be more advisory and less enforcing. While some charities officials already see their role this way, it is important to institutionalize and endorse that role.

In the business context, we may be less worried about dumb decisions because we are confident that the market will eventually correct them. In the charity context, we should be more concerned about any interim waste of charitable resources, along with the fact that there is no ultimate market correction for governance missteps. While AGs should not act as super-trustees of nonprofit organizations, charities bureaus are in the business of maximizing benefits for the charitable sector. They know about conserving charitable assets, and they work within the framework of the law and its norms of fairness.

For the protection of the sector as a whole and its reputation for doing good, we need a procedure that minimizes both real mistakes and opportunities for public embarrassment that do not translate into public benefits. Any enforcement that punishes following a breach is

171. The questions about governance on Form 990 might signal the aspirational standard. The sector itself can also offer such standards. See *Strengthening Transparency Governance Accountability of Charitable Organizations*, PANEL ON NONPROFIT SECTOR 90-91 (June 2005), http://www.neh.gov/files/divisions/fedstate/panel_final_report.pdf.

inferior to a mechanism that can prevent such a breach. The administration of the law needs to be more proactive because the media is likely to become more powerful, more ubiquitous, and more decentralized. Greater government participation is necessary to recalibrate the balance between private punishments and public law.