Auxiliary Organizations Association
The California State University

SAFEGUARDING CONTRIBUTIONS

By

John W. Francis and Robert E. Griffin

Professional Monograph Series

I. Purpose

For over two decades the *Auxiliary Organizations Association (AOA)*[1] has commissioned and published professional papers for its members on timely organization, governance and management subjects.

AOA continues the series with this monograph. Its primary purpose is to explore the notion that more legal protection of gift assets can be achieved by separating the gift management function in a separate auxiliary organization. Two corollary issues are analyzed, and some conclusions offered. The scope and detail of this analysis should provide a useful perspective for board members, managers and staff, as well as university administrators concerned about the effective structuring of campus auxiliary organization functions.

This paper does *not* constitute legal or compliance advice. The structuring of auxiliary organization functions varies from campus to campus depending upon a variety factors. *AOA* will endeavor to keep this monograph up-to-date. The analysis and conclusions in this monograph are those of the authors, not the *AOA* or its member organizations.

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[1] The *AOA*, a California public benefit nonprofit corporation, is organized to develop and foster sound relationships between members and with their customers and clients; and to provide governance and management development programs, services and publications. *AOA* members are auxiliary organizations serving campuses within the California State University. The *AOA* is *not* an auxiliary organization.

II. Background and Analysis

To what extent would donated gifts and endowments, now held for the exclusive benefit of a CSU university, enjoy more legal protection if held by a separate development auxiliary organization, rather than a multi-function auxiliary organization?

This question most recently appears as one of a series of "necessary university controls" in a report by the *Chancellor's Task Force on Grant & Contract Administration*. The core question raises two corollary issues deserving of analysis:

1. Are such funds now held by an existing multi-function auxiliary organization vulnerable to satisfy losses incurred as a result of other corporate activities of the entity?

2. Can such contributions be better safeguarded by separating them into an entity distinct from the existing auxiliary organization?

The following analysis and conclusions are organized around these two issues. Some final remarks are included.

Are the contributions-of-others held by an existing multi-function auxiliary organization for University purposes vulnerable to satisfy losses incurred as a result of other corporate activities of the auxiliary entity unrelated to either management of those assets or the purposes for which they were contributed?

Conclusion

The contributions-of-others to a multi-function auxiliary organization for purposes consistent with its fiduciary responsibilities are not generally available to satisfy losses caused by other corporate activity of that entity not related to its charitable functions. Absent fraud, misrepresentation, breach of fiduciary duties or abuse of corporate authority – and assuming the auxiliary entity has established and is following appropriate policies adopted by its governing board, consistent with California trust law and applicable financial standards and practices – charitable gifts (including trust funds) to the auxiliary entity for the exclusive use of University programs/purposes would not be subject to enforcement of a court-ordered judgment.

Analysis

The notion of creating a legal "fire wall" to protect donated assets from being tapped to satisfy civil court judgments obviously came out of work undertaken by Ketchum Inc. in 1993-94. Ketchum was engaged by the CSU to assess certain aspects of institutional advancement within the system. Two reports were issued. "Ketchum Report #1" included a recommendation urging bifurcation of a range of functions then performed by the CSU Foundation. Acting on the Report recommendations, the CSU Foundation was subsequently restructured – retaining its role and responsibility for philanthropic programs and activities on behalf of the CSU University system, the Chancellor and the Trustees. The other functions – commercial, entrepreneurial ones – were transferred to a new, separate auxiliary organization named the CSU Institute.

About this time, the Ketchum staff was made aware of a situation that may have tested the credibility and viability of a campus foundation in the minds of donors and donor-prospects. The well-publicized campus foundation activity had little or nothing to do with its charitable functions, but there was a perception of potential risk to the University's gifts held by the foundation.

The spin-off effect of the Ketchum recommendations, the restructuring of functions between the CSU Foundation and the CSU Institute, and the "situation" known widely among campus presidents, has been an interest in and actions by some campuses toward establishing separate, nonprofit tax-exempt organizations dedicated to the sole functions of the advancement (fund-raising) and gift/endowment fund management.

There is considerable policy-rationale of *general application* behind the Ketchum advice:

1. A single entity attempting to serve multiple and diverse functions may not succeed at all of them if they require distinct management and governance approaches;

2. The institutional advancement function needs a larger, highly distinguished, broad-based governing body, while such a board composition would often prove impractical for the oversight of commercial-type functions; and

3. Gifted assets might be buffered from risk exposures generally experienced by commercial, research and joint venture endeavors.

But, these general policy-rationales are just that; they have relative value based upon specific circumstances. They should not be viewed as legal principles or premises leading to either legal conclusions or justifying major corporate restructuring.

An auxiliary organization operating within the CSU is created from a dual statutory framework, and it operates within a third when performing charitable functions as the trustee or donee of gifts. Additionally, the auxiliary entity is subject to Federal and California tax laws as an organization exempt from corporate income taxation.

As a recognized auxiliary organization, the entity must conform its functions to the California Education Code, § 89900, et seq., and the California Code of Regulations, Title 5 (hereafter "Title 5"), §§ 42400-42602. It is chartered as a nonprofit, public benefit corporation under the Nonprofit Corporation Law at § 5000, et seq., and as the donee, trustee and/or beneficiary of contributions from others, is subject to various provisions of the California Probate Code and related Regulations.

Auxiliary organizations are authorized to perform the function of gift-donee (Title 5, § 42500(a)(10)). In this role, the auxiliary entity serves as the designated donee of contributions for University purposes through a written multi-year Operating Agreement. The governing Board of the auxiliary organization typically functions within a policy framework, not only for the acceptance of such contributions, but also for their proper management and use. Auxiliary management also establishes formal practices to implement those policies and applicable financial standards.

The auxiliary accepts contributions from donors in two basic capacities, and in some cases, in a dual role. Most gifts come to the auxiliary entity outright, some designated for specific programs, others as discretionary funds for campus purposes. The auxiliary entity also accepts gifts held formally *in trust*. In these instances, the entity serves as the trustee – and often as the remainder beneficiary – of the trust assets. In all cases, the auxiliary entity is held to fiduciary standards in managing these contributions (Corporations Code §§ 5140, 5231 & 5240; Probate Code §§ 16040, 16047 & 18506). In practice, such assets must be separately account for, and are not to be commingled with other corporate assets, or utilized for other corporate functions.

The classic "alter ego" doctrine disregards a corporation's separate existence, in certain circumstances, and liability of the corporation attaches to others (individuals or entities) affiliated with the corporation. Could this doctrine be applied to the situations where an auxiliary organization is the donee and/or trustee of private gifts, and either the University or the auxiliary entity incurs a liability stemming from activities unrelated to the auxiliary's donee role? Although several factors draw the attention of the courts when applying the "alter ego" doctrine, there are a few that seem especially influential: (1) the commingling or diversion of assets by the corporation and its affiliates; (2) misleading creditors as to the existence of the corporate entity; and (3) inadequate capitalization of the corporation. The courts often apply the "alter ego" doctrine when a corporation disregards normal corporate formalities, such as the preparation of Board minutes or conduct of governing board meetings.

California courts have adopted a variation of the "alter ego" doctrine that holds if a particular enterprise is conducted jointly by affiliated entities, each entity may under certain circumstances, be liable for the debts and obligations of the other(s). See Las Palmas Associates v. Las Palmas Center Associates (1991) 235 Cal. App. 3d 1220, 1248-52. Termed the "single enterprise" rule, the facts required to bring it into application require the affiliated external entity to be participating as a party in the day-to-day conduct of the activity causing the liability.

Neither the "alter ego" doctrine nor the "single enterprise" rule appears applicable to the circumstances at hand. For a university to be held liable for auxiliary organization activities exercised under statutorily mandated and regulatory supervised functions for such entities would be inconsistent with the Legislature's intent expressed in Education Code § 89901. There is also a well-known, fresh path of relevant court rulings and Attorney General Opinions that auxiliary organizations are, as a matter of law, separate from the host institutions that created them. Taken apart from the special circumstances under which auxiliary organizations operate in relation to their campuses, none of the court-acknowledged factors triggering the "alter ego" doctrine or the "single enterprise" rule are present with the situation being examined in this analysis.

Dating back to the earliest forms of auxiliary organizations serving California state colleges, and tracing through to contemporary auxiliary entities structured and operating under the Education Code, there has never been a case where a court has disregarded the separate corporate status of an auxiliary organization and applied the "alter ego" doctrine or the "single enterprise" rule.

As a condition of its existence as a public benefit corporation, an auxiliary organization may indeed be sued (Corporations Code § 5004). Furthermore, its *corporate* assets may generally be used to satisfy a court judgment (Corporations Code § 5005 and Civil Code § 106). From this point forward in the analysis of the statutes, a close trail must be followed.

Certain personal property is not subject to enforcement action (execution) on a money judgment. The interest of a trust beneficiary is excluded (Code of Civil Procedures § 669.720(a)(8)). This exclusion is not, however, a categorical one. A judgment-creditor may petition the court to reach trust property in satisfaction of a judgment in certain circumstances. See Code of Civil Procedures § 709.010 and Probate Code § 15300, et seq.

California trust law permits the creation of a valid trust relationship over real property through a written instrument, and, if funded with personal property, by clear and convincing evidence (Probate Code § 15200, et seq.). Thus, except in circumstances analyzed below, formal trust funds held by an auxiliary organization (either as trustee or as trustee/remainder beneficiary), would be immune from judgment creditor execution.

Furthermore, there is commonly clear documentation between a university and an auxiliary organization to support a legal argument that the auxiliary entity, in functioning as the designated donee of outright contributions for university programs, is acting in a trust capacity over such funds. The organization's articles of incorporation typically include a paramount clause to the effect that its' exclusive charitable purpose is "… to apply the funds and properties coming into its hands toward furthering the educational services carried on or approved by the administrative officers of the [named university]." All such assets are subject to an operating agreement, campus gift policies, and Trustees' policies that reinforce the fiduciary role of the auxiliary entity in managing gifted assets.

As mentioned above, there are limitations to exclusion of the trust assets from personal property subject to the judgment-creditor execution. Here is a hypothetical case:

> An auxiliary organization holds and manages funds given outright from a Trust Estate. These funds are designated to support operations of certain instructional programs of the university out of accounts also administered by the auxiliary entity. If, as a result of university or auxiliary organization activity or conduct relating to the programs, the university or the auxiliary organization became a money judgment-debtor for an amount beyond insurance coverage limits, the judgment creditor might prevail on an execution petition to the court to satisfy any remaining amount out of funds given by the donor. In this case, there is a causal relationship between the activity and the purpose designated for the contributed funds.

A search for relevant court decisions uncovered nothing recent or on specific point. From early cases a doctrine of "charitable tort immunity" has emerged. This doctrine holds that a charity should be, as a matter of public policy, immune from corporate liability for a broad range of civil claims. But the doctrine has been largely abrogated by a long and somewhat confusing line of decisions across several jurisdictions, and by California statutory law. Nevertheless, the courts seem to be reluctant to execute upon the contributed assets of charitable organizations for judgments obtained against the charity's for-profit activities. Cases involving churches are a good example. In an action for negligence stemming from a community bazaar sponsored by the church, the court refused to execute upon those assets contributed to the church. Recovery was limited to insurance, and other "commercial" assets.

Can the contributions-of-others be better safeguarded by separating them into an entity distinct from a multi-function auxiliary entity?

Conclusion

From our study and understanding of present auxiliary organization corporate and policy structure within the CSU, the general relationships between those auxiliary entities and their respective campuses, the financial and management standards and practices to which these entities adhere, and the present status of the law as analyzed above, no additional legal protection would be likely achieved by separating gift acceptance and management out of an existing multi-function auxiliary organization and into a separate auxiliary organization charged with this function as its sole purpose.

Analysis

A thorough review was completed of the literature surrounding not only the work performed by the Ketchum staff assigned to the two Reports commissioned by the CSU, but of contemporary studies by the American Association of State Colleges and Universities (AASCU), the Association of College and University Auditors, and the Council on Governmental Relations of the National Association of College and University Business Officers (NACUBO). Although the policy-rationales listed above are recurring themes in much of the literature, there is no mention of a principle that a public university's gifts are better safeguarded through a single-purpose gift-holding entity. The "situation" – contemporaneous to preparation of the Ketchum reports – on a CSU campus involving a multi-purpose Foundation lead to perceptions that the Foundation's role as official donee for campus gifts conflicted with its conduct and attendant liability.

Certainly such single-purpose entities can and are being created, and for the foreseeable future, their ability to manage the full range of gift programs will depend on service-support arrangements with an existing campus foundation. But that relationship, coupled with the relationships of the pre-existing and any new gift-holding entity to the University, would create an obvious complex of interlocking entities for judgment-creditor counsel to argue were it created as an attempt at asset concealment.

The "alter ego" doctrine and the "single enterprise" rule were discussed in the above analysis on the vulnerability of gift assets to satisfy multi-function auxiliary organization losses not associated with the donee-function. The creation of a separate, single-purpose development auxiliary entity for University private donations might, with the presence of factors discussed above, trigger those recovery-expansion theories in actions against a university or auxiliary organization by zealous plaintiffs attempting to reach assets held by the single-purpose entity. It would be crucial to fund, structure and operate the new gift-holding entity to not only obviate the appearance of any conflicting functions, but to avoid the factors the courts use to rationalize application of those recovery theories.

III. Concluding Remarks

A university and an existing multi-function auxiliary organization can be distinguished clearly as separate legal entities; but they stand and operate closely in a complex and often litigious environment. By force of events and through careful planning, they become more adept at managing risks on a collaborative basis. As between a university and any affiliated entity set up to accept and mange the contributions-of-others for campus purposes, no degree of corporate restructuring will safeguard those assets as well as the consistent practice of sound management and financial principles and policies over both *corporate* and *charitable* functions.

Judgment-creditor legal counsel will surely *attempt* ingenious arguments, and certainly the courts do exercise some discretion in reaching judgment-debtor assets. But, if a multi-function auxiliary organization has met applicable fiduciary and financial accounting standards in managing the contributions-of-others, it is very doubtful that those funds could be reached to satisfy a civil money judgment caused by unrelated corporate activities of that auxiliary organization. The risk seems greater that a court would view a single-purpose auxiliary entity as the more transparent attempt to harbor gifted assets from reach.

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