



## Nonprofit News Alert

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### Modifying Donor Restrictions on Funds: Can it be done?

Many charitable organizations receive gifts upon which the donor has put restrictions. A restriction may come in the form of an endowment with a spending limitation (e.g., income only), a limitation on the use of the gift (e.g., nursing scholarships), or both. Directors or trustees of charitable organizations have a duty under applicable law to abide by a donor's intent and restrictions regarding the use of a gift.

But sometimes unforeseen circumstances or the passage of time can cause such restrictions to interfere with the donor's fundamental charitable intentions in making the gift in the first place. Take, for example, the recent economic recession and the loss in value of many endowment funds. A strict spending limit or spending mandate on an endowment fund may create serious difficulties for an organization, either in its ability to continue programs and achieve its charitable mission, or in managing that fund appropriately for the future. Or, circumstances may have changed since the gift was made that makes fulfilling the donor's intent impracticable or impossible to fulfill - for example, a gift given several decades ago to fund research for a disease that has since been cured. Strict adherence to the donor restriction in this case would prevent the funds from being used for related charitable purposes.

Charitable organizations faced with such a dilemma regarding donor restricted funds have a few options for modifying such restrictions. In Washington state in particular, two options historically available under the common law – Deviation and Cy Pres -- have been codified by statute, and new Washington law provides a third and extremely useful option for modifying such restrictions without court involvement.

#### Deviation

Courts have historically used two doctrines—*deviation* and *cy pres* (pronounced "sigh-PRAY")—to allow the modification of restrictions on charitable gifts. The objective of both doctrines is to best effectuate the donor's intent and purpose. But while the two doctrines are related, there is a fundamental distinction: Courts apply deviation to make changes in the manner in which a charitable gift is carried out, whereas *cy pres* is applied in situations where a trustee or a charity seeks to modify or redefine the donor's specific charitable purpose.

Under the deviation doctrine, a charity may ask a court to modify restrictions on the way an institution is permitted to manage or administer a charitable gift, while still furthering the purposes of the donor. Under the doctrine of deviation, the primary purpose of the gift must remain intact—only administrative restrictions may be modified.

A court will usually permit deviation in the following circumstances: (i) where compliance with the prescribed means is impossible or illegal; (ii) where because of circumstances not anticipated by the donor, the modification or deviation will further the purposes of the gift; or (iii) where deviation from the restriction may permit the institution to carry out the donor's purposes in a more effective manner. The party seeking permission to deviate from the terms of the gift instrument has the burden of showing either changed circumstances or that relevant circumstances were unknown to the donor at the time the gift was made.

In a recent case<sup>1</sup>, the Washington Supreme Court held that a restriction on the sale of gifted property was an administrative provision subject to deviation, and not central to the purpose of the gift. In that case, the court found that the deed created a charitable trust, the primary purpose of which was the support and expansion of the church occupying the property and not the use of the specific parcel of land. The church was permitted to sell the property in order to acquire another parcel that better suited the needs of the church and its mission. In the case of a land or conservation trust, a court would likely hold just the opposite, given that the primary purpose of such gifts is to retain the character of the specific property.

## Cy Pres

Cy pres is a doctrine of equitable approximation. The court attempts to modify the primary purpose of the donor, apply the funds to an alternate objective, or find a substitute beneficiary that is sufficiently similar to what the donor provided in the gift instrument so that the court can reasonably conclude that the property is being used in a manner consistent with the donor's intent. Cy pres is appropriate when the donor's purpose has already been fulfilled, becomes illegal to perform, is impossible to fulfill, or is permanently impracticable of performance.

Charities should be cautious when seeking cy pres. The standard is stricter than deviation in that modifications are not allowed merely for changed circumstances where the funds could be used more efficiently. Moreover, courts may only apply the doctrine where the donor has expressed a broad, general intent to aid charity as a whole, or some particular class of charitable objects. The intent must not be a narrow grant to benefit a particular institution. If the gift instrument has an alternate beneficiary and the charity argues that the gift is impossible to perform, a court may award the gift to the alternate beneficiary rather than use cy pres to allow the charity to use the funds for other purposes.

## Uniform Prudent Management of Institutional Funds Act (UPMIFA)

In 2009, the Washington legislature enacted the Uniform Prudent Management of Institutional Funds Act, or UPMIFA, (Chapter 436, 2009 Laws), which governs the investment, management, expenditure, and modification of charitable funds. Notably, UPMIFA updates the existing statute governing such funds and codifies the doctrines of cy pres and deviation as applied to all charitable funds. Under UPMIFA, as under common law, the court will determine whether and how to apply cy pres or deviation and the state attorney general will receive notice and have the opportunity to participate in the proceeding. UPMIFA also gives a charity the authority to modify a restriction on a gift that is both old and relatively small, without the expense of a trip to court.

With regard to deviation, UPMIFA states that a court may modify restrictions on the management or investment of a charitable gift if "the restriction has become impracticable or wasteful, if it impairs the management or investment of the fund, or if, because of circumstances not anticipated by the donor, a modification of a restriction will further the purposes of the fund." Any such modification must, to the extent practicable, be made in accordance with the donor's probable intention. Again, the emphasis of deviation is on any restriction on the management or administration of a fund, and not its purpose or use. This provision is more or less a restatement of the common law discussed above, and the same concepts should apply. The burden will be on the party seeking the modification to show that the modification is necessary and will further the donor's purpose in making the gift.

With regard to cy pres, UPMIFA permits a court to modify the purpose of a fund or the restriction if such purpose or restriction "becomes unlawful, impracticable, impossible to achieve, or wasteful." Any such modification must be consistent with the charitable purposes expressed in the gift instrument. Here again, the provision mostly restates the common law discussed above, with one very notable addition. Under UPMIFA, a court may use cy pres where a restriction on use or purpose of a gift is "wasteful." This provides a means for charities to argue that a restricted use of funds, though possible to carry out, would not be an efficient use of the donor's gift. Of course, the proposed modification must still be consistent with the expressed charitable intent of the donor. A court is unlikely to approve a modification for an altogether unrelated purpose.

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<sup>1</sup> *Niemann v. Vaughn Community Church*, 154 Wn.2d 365 (2005). In a more recent case, *In re 1934 Deed to Camp Kilworth*, 149 Wn.App. 82 (2009), the Court of Appeals denied a similar attempt because it found that the deed in question did not create a charitable trust. Thus, the court had no authority to exercise its equitable powers over the matter.

Most notably, UPMIFA provides a useful tool for charitable organizations to unilaterally apply deviation or cy pres to relatively small and old gifts where the expense of going to court would be prohibitive. Under UPMIFA, if an organization determines that a restriction regarding the management, investment, or purpose of a fund is unlawful, impracticable, impossible to achieve, or wasteful, the organization may release or modify the restriction after giving 60-days' notice to the state attorney general. This power extends only to funds that have a total value of less than \$75,000 (with the limit increasing by \$2,500 every year) and that have been in existence for more than 20 years. Under any modification, the organization must also use the property in a manner consistent with the charitable purposes expressed in the gift instrument. Organizations should review their existing funds to determine if they have the authority under this provision to modify gift restrictions that are unlawful, impracticable, impossible to achieve, or wasteful.

Finally, though this article does not address the other provisions of UPMIFA, all charitable organizations should familiarize themselves with the entire statute. The new law provides guidance and authority to charitable organizations concerning the management and investment of funds, and modernizes the rules governing expenditures from endowment funds, to provide both stricter guidelines and flexibility to cope with fluctuating fund values.

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