ENFORCING THE DUTIES OF NONPROFIT FIDUCIARIES: ADVOCATING FOR EXPANDED STANDING FOR BENEFICIARIES

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INTRODUCTION
Oversight of the nonprofit sector has long been a public concern. Nonprofits are largely self-regulated; otherwise, authority to exercise oversight is largely in the hands of states’ attorneys general and the federal Internal Revenue Service (“IRS”). The public may vote with their dollars; innovations such as signaling intermediaries have helped the public vet organizations before they donate. In the for-profit context, the company’s owners may exercise at least a limited amount of oversight over the company’s board of directors through voting for board members, submitting stockholder proposals, and bringing lawsuits against the board members. By contrast, nonprofits do not have owners to which they are accountable. This stems from the defining feature of nonprofit corporations: the nondistribution constraint. Although nonprofits may and do earn profits, nonprofits may not distribute these profits to owners, directors, or trustees.

Standing in litigation against nonprofit boards of directors should be expanded to allow nonprofit beneficiaries to file lawsuits similar to stockholder derivative lawsuits in the for-profit context. Expanding standing to include beneficiaries will improve nonprofit oversight. Significantly, plaintiffs will have the ability to access nonprofits’ books and records and remove misbehaving directors. Nonprofits serve the public

4 Manne, supra note 2, at 230.
interest, and the public should be able to take a more active role in overseeing them.5

I. NONPROFIT FIDUCIARY DUTIES

While nonprofit boards have many functions,6 the fiduciary obligations of board members are the simple corporate law fiduciary principles derived from common law agency:7 the duty of care and the duty of loyalty.8 While some proposals for expanding standing also advocate for widening the scope of permitted claims,9 this Essay will advocate only for expanded enforcement of fiduciary duties.

The fiduciary duties of nonprofit directors are less stringent than those imposed on trustees.10 One of the first cases to apply these fiduciary standards to nonprofit directors was Stern v. Lucy Webb Hayes National Training School for Deaconesses & Missionaries,11 which stated that the corporate standard, rather than the more stringent trust standard, would apply to nonprofit directors.12 The architects of the Model Nonprofit Corporation Act followed this approach.13

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5 Nonprofits in the United States come in many different forms. This Essay will focus specifically on non-membership public benefit nonprofit corporations that qualify under 26 U.S.C. § 501(c)(3). This Essay will refer to these organizations simply as “nonprofits.” This Essay will not address churches, as they pose significant First Amendment issues beyond the scope of this Essay.

6 FISHMAN & SCHWARZ, supra note 1, at 127 (listing the six principal functions of a nonprofit board).

7 Id. at 134-35.

8 See Susan N. Gary, Regulating the Management of Charities: Trust Law, Corporate Law, and Tax Law, 21 U. HAW. L. REV. 593, 604-07 (1999). This Essay will focus only on the duty of care and the duty of loyalty. The third fiduciary duty, the duty of obedience, concerns specific charitable intent rather than the financial management of the nonprofit.

9 See, e.g., Rob Atkinson, Unsettled Standing: Who (Else) Should Enforce the Duties of Charitable Fiduciaries?, 23 J. CORP. L. 655, 658 (1998) (“Those who urge an expansion of such standing are often urging the creation of new classes of claims, or at least changes in the scope of preexisting claims, and not merely expansion of classes of permitted claimants.”).


12 Id. at 1013 (stating that although the current law was unsettled, corporate law provided the proper standard for fiduciary duties); see also Gary, supra note 8, at 610 (stating that the court in Stern “held that the trustees of a hospital organized as a nonprofit corporation were subject to the corporate standard rather than the trust standard with respect to fiduciary duties”).

13 See MODEL NONPROFIT CORP. ACT, INTRODUCTORY COMMENT TO SUBCHAPTER C (3d ed. 2008) (stating that the approach aligns with corporate law principles); see also Gary, supra note 8, at 610-11. The 1954 Model Nonprofit Corporation Act was silent on directors’
A. The Duty of Care

The duty of care is the standard of conduct pursuant to which directors discharge their responsibilities. Directors must fulfill their responsibilities diligently and make informed decisions. Only actions (or failures to act) that amount to gross negligence are considered violations of the duty of care. However, courts do not often find that a director has violated her duty of care because of the business judgment rule, which is a judicial presumption that board members act in an informed manner, in good faith, and in the best interest of the corporation. Derived from the for-profit corporate context, the business judgment rule also applies to nonprofit directors. In practice, nonprofit directors are held to an even lower standard than corporate directors. The theory behind the business judgment rule is that authorities and judges should not second-guess board members’ business decisions. However, the business judgment rule does not apply when directors abdicate their responsibilities and fail to act or act in bad faith.

14 The duty of care was first recognized in Briggs v. Spaulding, 141 U.S. 132, 152 (1891), cited in Brody, supra note 10, at 1443.
15 FISHMAN & SCHWARZ, supra note 1, at 136, 151-52 (discussing the duty of attention and the duty of informed decisionmaking).
16 Aronson v. Lewis, 473 A.2d 805, 813 (Del. 1984), overruled on other grounds by Brehm v. Eisner, 746 A.2d 244 (Del. 2000) (“[A] conscious decision to refrain from acting may nonetheless be a valid exercise of business judgment and enjoy the protections of the rule.”).
17 Id. at 812.
18 Brody, supra note 10, at 1443 (quipping that in the five-four decision of Briggs v. Spaulding, “the business world learned what a difficult standard this is to flunk”). “However, to apply a business corporate standard to all board members’ actions and responsibilities in all kinds of nonprofits may be too lenient. This approach ignores the special public purposes and public trust of the nonprofit corporation, the nature of the nonprofit board, and the inadequacy of internal control and enforcement.” James J. Fishman, The Development of Nonprofit Corporation Law and an Agenda for Reform, 34 EMORY L.J. 617, 676 (1985) (footnote omitted).
19 Aronson, 473 A.2d at 812.
20 FISHMAN & SCHWARZ, supra note 1, at 152-53 (stating that the business judgment rule is referred to as the “best judgment rule”).
21 Id. at 142 (discussing “a widespread attitude that nonprofit directors are essentially volunteers, and aggressive attempts to enforce their responsibilities are inappropriate and will discourage individuals from board service”).
22 Id. at 152-53.
23 Id. at 153.
B. The Duty of Loyalty

The duty of loyalty requires directors to act in the nonprofit’s best interest rather than their own. A director violates the duty of loyalty when she engages in self-dealing or uses her position improperly to obtain a personal benefit. Directors are also barred from usurping “corporate opportunities” that belong to the nonprofit organization. Plaintiffs have greater success bringing claims alleging duty of loyalty violations because corporations cannot limit a director’s personal liability for duty of loyalty breaches and the burden is on the director to prove the good faith and inherent fairness of the transaction.

II. TRADITIONAL FORMS OF ENFORCEMENT

A. Governmental Enforcement

Self-regulation is perhaps the most common form of oversight currently in force for nonprofits. Otherwise, oversight is largely entrusted to states’ attorneys general. All fifty states vest the attorney general with the authority to oversee nonprofits. This authority derives from English common law, where The Crown represented the interests of the public. The states “almost unanimously adopted this principle, reasoning that ‘the state, as parens patriae, superintends the management of all public charities or trusts, and in these matters acts through her attorney general.’” In Vidal v. Girard’s Executors, 23 U.S. (2 How.) 127 (1844).

24 Id. at 163.
25 Id. However, the Revised Model Nonprofit Corporation Act “provides that [even if a director engages in self-dealing or a transaction involving a conflict of interest,] the transaction will not be voidable if it was (1) fair at the time, (2) approved by the board of directors based on disclosure of the material facts of the transaction and a good faith, reasonable belief that the transaction was fair, or (3) approved by the attorney general.” Gary, supra note 8, at 613-14 (citing REVISED MODEL NONPROFIT CORP. ACT § 8.31(b) (1988)).
26 FISCHMAN & SCHWARZ, supra note 1, at 189.
28 Pepper v. Litton, 308 U.S. 295, 306 (1939) (“[Directors’] dealings with the corporation are subjected to rigorous scrutiny . . . .”).
29 Cf. FISCHMAN & SCHWARZ, supra note 1, at 221. One author has proposed that “the state or the nonprofit sector itself [should] commit to train those individuals involved with nonprofits in the importance of mission and organizational accountability, and to empower them to self-regulate.” Dana Brakman Reiser, Enron.org: Why Sarbanes-Oxley Will Not Ensure Comprehensive Nonprofit Accountability, 38 U.C. DAVIS L. REV. 205, 276 (2004).
31 Id. at 40.
32 Id. at 40-41 (quoting People ex rel. Ellert v. Cogswell, 45 P. 270, 271 (Cal. 1896)).
33 43 U.S. (2 How.) 127 (1844).
the United States Supreme Court recognized the existence of charities at common law and mentioned the attorney general’s enforcement powers.\footnote{Id. at 195; see also Blasko et al., supra note 30, at 43.} However, there are significant problems with entrusting nonprofit oversight to attorneys general exclusively. First, attorneys general have broad mandates and slim staffs.\footnote{See Blasko et al., supra note 30 at 38-39.} Perhaps more compellingly, “the typical state attorney general is an elected political official for whom the supervision of charitable organizations offers little political payoff.”\footnote{Jonathan Klick & Robert H. Sitkoff, Agency Costs, Charitable Trusts, and Corporate Control: Evidence from Hershey’s Kiss-Off, 108 COLUM. L. REV. 749, 751 (2008).} Sometimes, the political incentives point in the other direction and lead attorneys general to intervene in charitable matters when it is politically beneficial, rather than when it serves the public interest.\footnote{See Klick & Sitkoff, supra note 36, at 777-78 (discussing then-Pennsylvania Attorney General Mike Fisher, who was the Republican candidate for governor during his investigation and negotiations with the Hershey trust: “Prior to the election, Fisher had run television ads in which he claimed to have saved over 6,000 Hershey jobs. [Although Fisher lost the gubernatorial election, in] 2003 . . . President George W. Bush nominated Fisher to be a circuit judge for the United States Court of Appeals for the Third Circuit.”); AMERICAN LAW INSTITUTE, PRINCIPLES OF THE LAW OF NONPROFIT ORGANIZATIONS, ch. 6, at 2 (Tentative Draft No. 3, 2011) (“[T]he incentives of this near-universally elective office sometimes impel the attorney general to ignore cases that are politically dangerous, and to jump into matters that are politically irresistible but implicate only matters properly left to charity managers.”).}

The level of enforcement exercised by attorneys general varies drastically from state to state. While New York’s charities division has been described as “really active,” due to limited resources, even it has “no choice but to go after [only] the most egregious examples” of charity mismanagement, such as the Attorney General’s recent investigation of Cooper Union.\footnote{James B. Stewart, Cooper Union Inquiry Puts Nonprofits on Notice, N.Y. TIMES, Apr. 10, 2015, at B1, available at http://www.nytimes.com/2015/04/10/business/cooper-union-inquiry-puts-nonprofits-on-notice.html.} Thirty states and the District of Columbia focus solely on consumer protection, while only twenty states have a charities division within the attorney general’s office.\footnote{See Links to State Charity Officials, NORTH CAROLINA DEP’T OF STATE, http://www.secretary.state.nc.us/csl/scolinks.aspx (last visited July 1, 2015).} All fifty states and the District of Columbia have online forms where residents can submit complaints about charities.\footnote{See id.} Attorneys general often do not actively exercise oversight over nonprofits unless they receive a complaint or learn about mismanagement through a newspaper report.\footnote{See Fishman & Schwarz, supra note 1, at 170-71 (discussing the Boston Globe’s investigation of Paul Cabot, which spurred the Massachusetts Attorney General to action).} As the Massachusetts Attorney General’s Office (AGO) so aptly states, “[t]he AGO’s...
oversight authority is primarily exercised by providing the public with information regarding charitable organizations and charitable fundraising.\textsuperscript{42}

Congress and state legislatures can enact (and some have enacted)\textsuperscript{43} more stringent statutory reporting requirements.\textsuperscript{44} The most significant reporting requirement is the federal Form 990, which most large nonprofits must file annually with the IRS.\textsuperscript{45} However, small nonprofits with receipts less than or equal to $50,000 are only required to file the Form 990-N.\textsuperscript{46} The requirement to file Form 990 may encourage stronger financial management because nonprofits may choose to hire outside financial professionals to review their accounts and prepare their financial statements.\textsuperscript{47}

The Form 990 does not provide outside observers much information about the nonprofit’s financial management strength. Many lawmakers believe that sunlight is the best disinfectant.\textsuperscript{48} Although the Form 990 is publically available,\textsuperscript{49} the information provided gives only a limited view of a charity’s financial information. A significant hurdle to nonprofit oversight is information asymmetry.\textsuperscript{50} Requiring limited disclosures such as the Form 990 does not greatly contribute to the goal of public oversight.


\textsuperscript{43} For example, Massachusetts requires nonprofits that have “gross support and revenue of more than $200,000 in a fiscal year to submit financial statements audited or reviewed by an independent certified public accountant (CPA).” Audits and Reviews, MASS.GOV, http://www.mass.gov/ago/doing-business-in-massachusetts/public-charities-or-not-for-profits/information-for-existing-charities/audits-and-reviews.html (last visited July 1, 2015) (citing MASS. GEN. LAWS, ch. 12, § 8F). If the organization’s gross support and revenue exceeded $500,000, the financial statements must be audited, which is a more onerous process than a review. \textit{Id.} California requires charities with gross revenues of $2 million or more to prepare audited financial statements. \textit{Fishman} & \textit{Schwarz}, supra note 1, at 225.

\textsuperscript{44} See \textit{Fishman} & \textit{Schwarz}, supra note 1, at 223-24 (discussing state and federal filing requirements, including Form 990).

\textsuperscript{45} Nonprofits with gross receipts greater than $50,000 must file the Form 990-EZ or the Form 990. Which Forms Do Exempt Organizations File?, IRS.GOV, http://www.irs.gov/Charities--&-Non-Profits/Form-990-Series-Which-Forms-Do-Exempt-Organizations-File%-3F-%28Filing-Phase-In%29 (last visited July 2, 2015).


\textsuperscript{47} \textit{Cf. Fishman} & \textit{Schwarz}, supra note 1, at 126.

\textsuperscript{48} See \textit{American Law Institute}, supra note 37, at ch. 6, p.1.


\textsuperscript{50} See Manne, supra note 2, at 268.
In addition to administering the Form 990, the IRS also exercises oversight over nonprofit organizations by granting and retracting 501(c)(3) status and performing field and office audits and compliance checks. However, the efficacy of IRS investigations is questionable, as illuminated by a recent egregious fraud that survived an IRS investigation. At the state level, some commentators have called for appointing oversight boards, similar to the New York Board of Regents, which would specialize in charitable oversight. South Carolina and West Virginia also have created “Commissions on Charitable Organizations” to oversee charities.

B. Public Enforcement

Since nonprofits rely, at least in theory, on donations from the public, donors may vote with their dollars. The idea behind this theory of enforcement is that people will not donate to nonprofits that are mismanaged. However, information asymmetries mean that donors are unable to assess the management of nonprofits. Furthermore, donations from individuals comprise a small percentage of nonprofits’ funds. Many people donate to nonprofits in their own community, where they feel that they can assess the nonprofit’s impact and know the people involved. Nonprofits are difficult to oversee because even their outcomes are difficult to assess, let alone their inner workings. For-profit corporations are driven by the search for ever-increasing

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52 See Ken Stern, The Charity Swindle, N.Y. TIMES, Nov. 26, 2013, at A25 (detailing the scheme perpetrated by the U.S. Navy Veterans Association).
53 See Manne, supra note 2, at 266.
54 Blasko et al., supra note 30, at 50. “These commissions, however, are largely advisory and administrative in nature. Such commissions still rely on the attorney general (or, in the case of West Virginia, the prosecuting attorney of the county) to actually bring suit.” Id. at 51 (footnote omitted).
55 FISHMAN & SCHWARZ, supra note 1, at 13 (stating that only 12% of the nonprofit sector’s funds came from contributions in 2005). However, individuals make up the lion’s share of charitable giving. Id. at 14 (showing that 75% of charitable giving came from individuals in 2008).
57 See Atkinson, supra note 9, at 684 (“It is relatively easy for me to channel my charitable giving to a congregation where my mother-in-law is in charge, or even to a denomination where she is at least in touch with those who are.”).
58 For example, one of the only organizations committed to a well-rounded investigation of nonprofits recommends only four (all internationally-focused). See About GiveWell, GIVEWELL, http://www.givewell.org/about (last visited July 2, 2015) (“Unlike charity evaluators that focus solely on financials, assessing administrative or fundraising costs, we conduct in-depth research aiming to determine how much good a given program accomplishes (in terms of lives saved, lives improved, etc.) per dollar spent.”).
profits. Although many managers would like to be measured by the quality of their product or service, the majority of investors are focused solely on profitability, which makes the limited nature of purely financial metrics more appropriate in the for-profit context.\textsuperscript{59} Although there has been an attempt to use percentage overhead as a shorthand for management strength, other nonprofit experts have cautioned against this approach.\textsuperscript{60} Overhead expenditures are necessary precisely to ensure that the nonprofit is well-managed.

Signaling intermediaries have emerged to assist donors in choosing well-managed nonprofits,\textsuperscript{61} but these intermediaries do not offer a complete picture. The Better Business Bureau Wise Giving Alliance’s Charity Seal Program requires participating nonprofits to pay a large annual fee.\textsuperscript{62} Charity Navigator, which touts itself as “America’s largest charity evaluator,” evaluates only large nonprofits.\textsuperscript{63} Any nonprofit can participate in GuideStar’s transparency efforts, but the nonprofits themselves provide the information available regarding the organization’s financials, goals, programs, and accomplishments.\textsuperscript{64} GiveWell has attracted attention for its thorough charity analysis. However, it recommends only four international nonprofits\textsuperscript{65} and does not consider itself a “charity evaluator.”\textsuperscript{66}

\textsuperscript{59} FISHMAN & SCHWARZ, supra note 1, at 128 (“[T]he talisman of profit-seeking activity[] is easier to measure than nonprofit effectiveness.”).


\textsuperscript{61} Reiser, supra note 29, at 273.

\textsuperscript{62} Charity Seal License Fee Schedule, GIVE.ORG, http://www.give.org/for-charities/about-charity-seal-licensing/charity-seal-license-fee-schedule/ (last visited July 2, 2015) (detailing annual fees from $1,000 to $30,000).

\textsuperscript{63} What Kind of Charities Do We Evaluate?, CHARITY NAVIGATOR, http://www.charitynavigator.org/index.cfm?bay=content.view&cpid=32#.VKrTQyvF81x (last visited July 2, 2015) (stating that the organization only evaluates charities whose public support is more than $500,000 and total revenue is more than $1,000,000).

\textsuperscript{64} FAQs: Nonprofit Profiles, GUIDESTAR, http://www.guidestar.org/rxg/help/faqs/nonprofit-reports/index.aspx (last visited July 2, 2015) (“Financial information comes from the IRS Business Master File of exempt organizations and IRS Forms 990, 990-EZ, and 990-PF. Other information, such as an organization’s programs, accomplishments, and goals, are obtained directly from the organization or from the organization’s Form 990 or 990-EZ.”).


\textsuperscript{66} Common Questions, GIVEWELL, http://www.givewell.org/about/FAQ (last visited July 2, 2015) (“We recommend few charities by design, because we see ourselves as a ‘finder of great giving opportunities’ rather than a ‘charity evaluator.’ In other words, we’re not seeking to classify large numbers of charities as ‘good’ or ‘bad’; our mission is solely to identify, and thoroughly investigate, the best.”).
Foundations, especially large ones such as the Bill and Melinda Gates Foundation and the Ford Foundation, exercise oversight through requiring nonprofits to submit recent audits as a part of their grant applications. These audits are performed by outside, private accounting firms who are best equipped to expose financial mismanagement. However, these audits are paid for by the nonprofits themselves, and this bonding cost is an overhead expense.

III. EXPANDING OVERSIGHT THROUGH EXPANDED STANDING

In addition to traditional enforcement mechanisms, the public may exercise oversight through filing lawsuits. In order for a plaintiff to meet constitutional standing requirements, the plaintiff must have suffered an injury, caused by the defendant, which a court ruling could redress. The Supreme Court has also crafted prudential limitations, for example, limiting suits raising “generalized grievances.” In the nonprofit context, the courts’ greatest prudential concern is that nonprofits’ assets will be wasted on vexatious litigation which is not in the public interest. Derivative actions in the for-profit corporate setting are brought by stockholders to enforce the corporation’s rights. Claims are derivative if the corporation (rather than the stockholder) has been harmed and the corporation will receive the benefit of the court’s ruling.

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69 Id.

70 Blasko et al., supra note 30, at 42 (footnotes omitted) (“The concern that the corpus of the charity might be dissipated in litigation also has encouraged standing limitations, and for the public good courts try to protect charitable resources so that charitable dollars can be spent on the charity’s philanthropic purpose.”); see also Hooker v. Edes Home, 579 A.2d 608, 612 (D.C. Cir. 1990) (articulating that the policy reasons for limiting enforcement to the attorney general, including the “large and constantly shifting nature” of the benefited class and the danger of “vexatious litigation”).

71 Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984), overruled on other grounds by Brehm v. Eisner, 746 A.2d 244 (Del. 2000) (“[A] stockholder is not powerless to challenge director action which results in harm to the corporation. The machinery of corporate democracy and the derivative suit are potent tools to redress the conduct of a torpid or unfaithful management. The derivative action developed in equity to enable shareholders to sue in the corporation’s name where those in control of the company refused to assert a claim belonging to it.”).

72 Tooley v. Donaldson, Lufkin & Jenrette, Inc., 845 A.2d 1031, 1036 (Del. 2004) (footnotes omitted) (“The derivative suit has been generally described as ‘one of the most
behind derivative actions is that stockholders should have the opportunity to “animate” the corporation since it is unable to animate itself.\(^\text{73}\) In the for-profit context, a person seeking to bring a derivative action must be a “proper plaintiff”: she must have been a stockholder at the time of the alleged wrongdoing and hold stock throughout the pendency of the action.\(^\text{74}\) In parallel with courts’ concerns regarding vexatious litigation against nonprofits, this prudential requirement reflects a “policy . . . to prevent so-called ‘strike suits’ whereby individuals purchase shares in a corporation with litigious motives.”\(^\text{75}\)

Nonprofits lack stockholders to animate the corporation through derivative suits. Instead, courts widely hold the view that only the attorney general or a director has standing to sue.\(^\text{76}\) As discussed above, attorneys general are ill-equipped to effectively enforce fiduciary obligations. Expanded standing is needed to enforce board member fiduciary obligations. Issues regarding who would constitute a proper plaintiff implicate prudential, rather than constitutional, concerns regarding standing, because derivative suits address the injury to the corporation rather than the individual. It is firmly established that merely being a taxpayer does not give one a sufficient interest to warrant standing.\(^\text{77}\) Donor standing seems at odds with the tax law theory behind charitable giving. Once a donor gives to a nonprofit, he or she loses control of the gift (or may lose the charitable deduction).\(^\text{78}\) Recognizing this, courts have refused to confer standing to donors.\(^\text{79}\) Relator actions seem promising at first, but often implicate the same political problems associated with attorneys general because often the attorney general must consent to the suit.\(^\text{80}\)

interesting and ingenious of accountability mechanisms for large formal organizations.’ It enables a stockholder to bring suit on behalf of the corporation for harm done to the corporation. Because a derivative suit is being brought on behalf of the corporation, the recovery, if any, must go to the corporation.”).

\(^\text{73}\) See Aronson, 473 A.2d at 811.


\(^\text{76}\) See Fishman, supra note 18, at 669-70.

\(^\text{77}\) See Atkinson, supra note 9, at 679 (“As a matter of federal law, taxpayer standing is virtually a dead letter.”); see also Valley Forge Christian Coll. v. Ams. United for Separation of Church & State, 454 U.S. 464, 476-82 (1982) (surveying historical taxpayer standing requirements).

\(^\text{78}\) Fishman & Schwarz, supra note 1, at 233 n.1 (“Pursuant to § 170(a) of the Internal Revenue Code and § 1.170A-1(c) of the Treasury Regulations, an income tax deduction for a charitable contribution is disallowed, unless the taxpayer has permanently surrendered ‘dominion and control’ over the property or funds in question.”).

\(^\text{79}\) See, e.g., Carl J. Herzog Found., Inc. v. Univ. of Bridgeport, 699 A.2d 995, 1002 (Conn. 1997), cited in Gary, supra note 8, at 616 n.197.

\(^\text{80}\) Manne, supra note 2, at 250 (explaining that in some states, “[t]he attorney general must consent to the suit; the relator must pay for costs recovered against the plaintiff, and the attorney general retains control over the suit.”).
Beneficiaries are the most promising class of potential plaintiffs.\textsuperscript{81} Beneficiaries are those for whom the nonprofit corporation was established.\textsuperscript{82} A nonprofit’s beneficiaries are best determined by looking at its organizing document, where a nonprofit is required to state its exempt purpose(s).\textsuperscript{83} Combining the theories behind stockholder derivative actions from corporate law with the “special interest” doctrine from trust law has led some courts to find that beneficiaries are proper plaintiffs who will adequately uphold the best interests of the charity.\textsuperscript{84}

Scholars Blasko, Crossley, and Lloyd identified four elements that courts consider when evaluating whether a plaintiff has the requisite “special interest” to warrant standing.\textsuperscript{85} These factors include:

(a) the extraordinary nature of the acts complained of and the remedy sought by the plaintiff; (b) the presence of fraud or misconduct on the part of the charity or its directors; (c) the state attorney general’s availability or effectiveness; (d) the nature of the benefitted class and its relationship to the charity.\textsuperscript{86}

The presence of only one of these elements may be sufficient to determine that a plaintiff has a special interest.\textsuperscript{87} If two or more factors point in different directions, the court will balance these factors.\textsuperscript{88}

These factors are explicit manifestations of the attorney general’s historic role in overseeing charitable organizations and courts’ concern that allowing litigation against nonprofits will cause nonprofits’ assets to be wasted on vexatious litigation. However, expanding standing for beneficiaries will not have the level of negative effects feared by scholars and courts.\textsuperscript{89} Providing standing will not make plaintiff-beneficiaries super-administrators of nonprofits.\textsuperscript{90} Although not acting as relators for the attorney general, the forms

\textsuperscript{81} Cf. Blasko et al, \textit{supra} note 30, at 52-59.

\textsuperscript{82} See \textit{INTERNAL REVENUE SERV.}, \textit{INTERNAL REVENUE MANUAL} 7.25.3.3.7 (Feb. 23, 1999), \textit{available at} http://www.irs.gov/irm/part7/irm_07-025-003.html (“A charitable organization or trust must be set up for the benefit of an indefinite class of individuals . . . ”).


\textsuperscript{84} Blasko et al., \textit{supra} note 30, at 59, 61 (“While corporate law is often applied directly by courts in the particular context of a derivative-type suit against a nonprofit corporation, private trust law serves as more of a backdrop for courts in their evaluation of the standing issue as it applies to both charitable trusts and charitable corporations.”).

\textsuperscript{85} Blasko et al., \textit{supra} note 30, at 61-78.

\textsuperscript{86} \textit{Id.} at 61.

\textsuperscript{87} \textit{Id.}

\textsuperscript{88} \textit{Id.}

\textsuperscript{89} See \textit{supra} note 70 and accompanying text.

\textsuperscript{90} See Blasko et al., \textit{supra} note 30, at 47 (citing \textit{In re Horton’s Estate}, 90 Cal. Rptr. 66, 68 (Cal. Ct. App. 1970)).
of relief available to plaintiffs will be equivalent to those available to the attorney general. Plaintiffs will not be able to control or manage the nonprofit’s day-to-day management and internal affairs; rather, plaintiffs will merely be able to seek redress for demonstrated failures of fiduciary duties.\textsuperscript{91}

Furthermore, demand requirements associated with derivative suits require that plaintiffs allege particularized facts to enable them to move forward with the suit.\textsuperscript{92} Derivative actions are still quite difficult to bring. In order to retain control of the suit, the plaintiff must show that demand is excused – that is, the board is incapable of bringing the suit itself.\textsuperscript{93} Furthermore, the presumption that board members act in accordance with the business judgment rule is so strong that unless a plaintiff, alleging that a board member has breached the duty of care, pleads particular facts that present a prima facie case that demand would be futile, the court will grant a defendant’s motion to dismiss for failure to make a demand.\textsuperscript{94}

In addition to the demand requirement, plaintiffs also face a heightened pleading standard under Federal Rule of Civil Procedure 23.1 and analogous state rules.\textsuperscript{95} Nonprofits will not have to spend a great deal of resources defending at the Rule 23.1 stage because the high burden rests solely with the

\textsuperscript{91} Id. ("[The attorney general] has ‘no control over, or right to participate in, the contractual undertakings of charities.’ The attorney general has standing to seek redress for demonstrated abuse of trust management, but cannot control or manage the every-day affairs of charities.") (quoting In re Horton’s Estate, 90 Cal. Rptr. 66, 68 (Cal. Ct. App. 1970)).

\textsuperscript{92} In re Tyson Foods, Inc., 919 A.2d 563, 582 (Del. Ch. 2007) (discussing demand futility).

\textsuperscript{93} See Rales v. Blasband, 634 A.2d 927, 932 (Del. 1993) (citations omitted) ("Because directors are empowered to manage, or direct the management of, the business and affairs of the corporation, . . . the right of a stockholder to prosecute a derivative suit is limited to situations where the stockholder has demanded that the directors pursue the corporate claim and they have wrongfully refused to do so or where demand is excused because the directors are incapable of making an impartial decision regarding such litigation."). Furthermore, state statutory over lays may still require that the attorney general is an indispensable party to the action in the nonprofit context. Blasko et al., supra note 30, at 44-45 (citing MASS. GEN. LAWS. ch. 12, § 8G (1986)).

\textsuperscript{94} Aronson, 473 A.2d at 807-08, 812. The court illuminated just how difficult it can be for a plaintiff to rebut the business judgment presumption: “Technically speaking, it has no role where directors have either abdicated their functions, or absent a conscious decision, failed to act. But it also follows that under applicable principles, a conscious decision to refrain from acting may nonetheless be a valid exercise of business judgment and enjoy the protections of the rule.” Id. at 813 (footnote omitted).

\textsuperscript{95} See Tyson Foods, 919 A.2d at 582 (footnote omitted) (“In the context of a motion to dismiss under Rule 23.1 . . ., plaintiffs may not rely upon the notice pleading standards of Rule 8(a)."); Fed. R. Civ. P. 23.1(b) (“The complaint must be verified and must . . . state with particularity . . . any effort by the plaintiff to obtain the desired action from the directors or comparable authority and, if necessary, from the shareholders or members; and . . . the reasons for not obtaining the action or not making the effort).
plaintiff. However, these suits will put directors on notice and may lead to investigations by the news media or attorneys general.

A. Forms of Relief

The first factor in the “special interest” analysis described above manifests courts’ concern regarding the form of relief sought by the plaintiff. As with stockholder derivative actions, the forms of relief that plaintiffs may hope to obtain include “restitution, recovery of damages, injunctive relief, disclosure of information, and removal and replacement of the fiduciary.” However, some of these remedies uniquely counsel in favor of standing in nonprofit context because they are unavailable outside of litigation.

Beneficiary claims against directors for violations of the duty of loyalty would result in the nonprofit directly recovering damages and restitution, as is the case in the for-profit context. Information disclosure and removal and replacement of the fiduciary are not otherwise available outside of litigation. These remedies may be especially important when a director has violated their duty of care. For-profit stockholder plaintiffs rarely succeed when alleging duty of care violations, but there are alternative means for stockholders to inspect the corporation’s books and records and to remove board members through voting. Beneficiaries may be able to prevail on claims of duty of care violations because beneficiaries have no other recourse.

Stockholders of for-profit corporations have the statutory right to inspect the corporation’s books and records in advance of stockholder meetings. Furthermore, stockholders have a statutorily-created ability to file suit against the corporation in order to inspect the corporation’s books and records for “any proper purpose.” The public has no such right to access nonprofits’ books and records. Expanded standing will allow plaintiffs to seek information disclosure, including an accounting. These disclosures will reduce the.

96 FISHMAN & SCHWARZ, supra note 1, at 7 (“Major newspapers began to assign reporters to cover charities and philanthropy with a critical eye, and the print media emerged as an influential watchdog of nonprofit sector behavior.”).

97 Atkinson, supra note 9, at 662; FISHMAN & SCHWARZ, supra note 1, at 185 (“For breaches of the duty of care by a fiduciary involving inattention or inaction in the absence of self-dealing, [some] courts have subjected fiduciaries to equitable sanctions, such as removal or injunctions to stop the inappropriate behavior. Breaches of the duty of loyalty stand on a different footing. Courts have employed civil and criminal penalties, and attempted to recapture improper gains or even imposed punitive damages.”).


100 See id. § 220(c) (2011 & Supp. 2014).

101 See Blasko et al., supra note 30, at 62 (footnote omitted) (“An action brought by a party for the purpose of gaining access to a charity’s financial or administrative records may be allowed regardless of whether the attorney general has moved to enforce any charitable obligations. Requiring the charity to present its records for inspection does not generally
information asymmetry that is a significant source of the problems in the nonprofit sector.102

The ability to remove fiduciaries is particularly interesting in the context of non-membership public benefit nonprofits. These nonprofits have self-perpetuating boards.103 In the for-profit context, stockholders and members exercise control, even if limited, through voting for board members. Conversely, only other members of the board104 have the ability to remove non-membership nonprofit board members. Plaintiffs proving sufficient facts to show fiduciary failures would be able to remove board members.

CONCLUSION

Nonprofits are largely self-regulating. Attorneys general, the primary external regulators of nonprofits, have limited resources and sometimes conflicting political interests that impede their ability to oversee nonprofits effectively. The public should have the opportunity to fill the void in enforcement through litigation similar to stockholder derivative lawsuits in the for-profit context. Courts should stake a more expansive view of standing to allow beneficiaries to file lawsuits against nonprofit board members. Plaintiff-beneficiaries would be able to access nonprofits’ books and records and remove misbehaving directors – remedies that are not available outside of litigation, unlike in the for-profit context. The difficult hurdles that plaintiffs must overcome in derivative litigation will prevent vexatious litigation while enhancing nonprofit oversight.

102 But see Manne, supra note 2, at 268 (“Information asymmetries, a root cause of the problems in the nonprofit sector, would not be overcome merely by expanding standing.”).
103 See Fishman, supra note 18, at 669-70.
104 Or the attorney general through filing a lawsuit.