Corporate Insights: Modifying or Lifting Charitable Fund Restrictions

BY PETER J. MARTIN • APRIL 22, 2024

Restricted funds are monies donated or bequeathed to a charity or non-profit organization such as a museum that come with limitations imposed by the donor on the investment, management or use of the funds. Examples include a prohibition on spending principal or a requirement that funds be used only for a specified program. Such restrictions can make full use of the funds impracticable or impossible.

What happens if the charity wants to use these funds despite such restrictions, but the donor has died and there are no donor representatives available to consent to changes to the restrictions? In Massachusetts, the charity will need the approval of the Attorney General's Office ("AGO") and ultimately a Supreme Judicial Court ("SJC") decree releasing the restrictions to enable the full, expanded use of these financial assets.

This process requires an understanding of the various legal doctrines that apply to releasing fund restrictions and the techniques available, depending on the size, age and nature of the charitable fund restrictions.

Some funds have purposes that have become unlawful, impossible, impracticable or wasteful. An example is a "free bed" fund at a hospital that pre-dates Medicaid assistance for indigent patients. For charities that wish to use such a fund for distinctly different purposes, such as paying a patient's out-of-pocket costs, the charity would need to obtain AGO assent and an SJC order under the doctrine of *cy pres* (shortened from a French phrase meaning "as near as possible").

Other funds have management, investment or durational restrictions that are compatible with the charity's charitable activities but interfere with the accomplishment of those activities, such as a geographical restriction on the use of funds to conserve land with respect to a location where there are no conservable parcels remaining. In that case, the charity would seek what is called "equitable deviation" from that restriction, also requiring AGO assent and an SJC decree.

Not all releases from fund restrictions require assent by the AGO and an SJC decree. Some restrictions found in smaller, older funds may be released through a technique called administrative modification, which requires only the assent of the AGO. This method is available for funds at least 20 years old that have a value of less than $75,000.

Recently, the Covid pandemic caused the Attorney General's Office to produce guidance that permits charities to borrow against the value of their endowment funds once they have exhausted other techniques such as seeking donor release of the spending restrictions. In order to obtain permission to borrow against the principal of an endowment fund, the charity must convince the AGO and the SJC that such borrowing will not simply delay an inevitable closure of

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the charity, and that the charity has a reasonable business plan for repayment.

Charities with a variety of donor-restricted funds should identify those funds, distinguishing them from funds whose use has been restricted or managed by the charity's own board. They should assess whether they have older, smaller funds that might be eligible for administrative modification. They should try to discern to the extent possible the general charitable intent of those donors who have imposed restrictions that are troublesome, and either identify a changed purpose that is as close as possible to that intent, or cause a change in the donor's restrictions that make the fund more usable consistent with donor intent.

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