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Policing Charitable Organizations: Whose Responsibility Is It?

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INTRODUCTION

The director of a small charity faces a tough predicament. He needs money for growing medical expenses. He knows he can quietly dip into his charity's funds to meet these mounting obligations. However, the question he is most concerned about is: Will anyone notice if funds are missing?

Traditionally, the state attorney general's office has been responsible for overseeing a state's charitable sector and ensuring directors' compliance with fiduciary standards.[1] Scholars have long criticized the current charitable oversight system.[2] Louisiana is no exception. In Louisiana, no decisions have been reported of the attorney general bringing suit against a charitable director for violating good governance standards. In fact, even when parties other than the attorney general challenge a charitable organization's operations, courts have passed on the opportunity to decide cases using laws relating to nonprofit organizations, choosing instead to decide the cases using contract law.[3]

Despite many calls for change in the enforcement model for charitable oversight,[4] states have left the authority to police charities with the respective state attorney general's office.[5] Many commentators believe that state attorney general offices are understaffed and underfinanced, and this lack of resources prevents them from holding directors accountable for violating their fiduciary responsibilities.[6] Given the challenges facing the current system of enforcement, these same scholars have suggested a

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1. Thomas Lee Hazen & Lisa Love Hazen, *Punctilios and Nonprofit Corporate Governance—A Comprehensive Look at Nonprofit Directors' Fiduciary Duties*, 14 U. PA. J. BUS. L. 347, 403 (2012).
2. *See infra* Part III.
3. *See, e.g.*, New Orleans Opera Ass'n, Inc. v. S. Reg'l Opera Endowment Fund, 993 So. 2d 791, 799 (La. Ct. App. 2008) (deciding the case on contract law rather than nonprofit law when a charitable trust was accused of misappropriating assets).
4. *See infra* Part III.
5. *See, e.g.*, CAL. CORP. CODE §§ 5142(a)(5), 5250, 6511 (West 2014); N.Y. NOT-FOR-PROFIT CORP. LAW § 112 (Mckinney 2014); REVISED MODEL NONPROFIT CORP. ACT §§ 1.70, 3.04(b)–(c), 8.10 (a), 14.03–.04 (3d ed. 2008).
6. James J. Fishman, *Improving Charitable Accountability*, 62 MD. L. REV. 218, 262–63 (2003).

variety of new models that are a better fit to enforce charitable fiduciary standards.[7]

This Comment proposes a self-funded state regulatory organization that is responsible for charitable oversight and regulation within Louisiana, replacing the current regulatory system under the attorney general's office. No perfect model or answer exists to the problem of properly regulating the charitable sector; however, this self-funded organization would help ensure proper regulation of Louisiana's charitable sector and place authority in a dedicated enforcement body, whose only task would consist of overseeing charities.

Part I of this Comment provides an overview of charitable organizations and director fiduciary standards. Part II explains the current model of enforcement and the problems with the system. Part III discusses various scholarly proposals for new models of enforcement. And finally, Part IV explains why a self-funded regulatory organization best ensures proper oversight of charities and their directors.

I. THE CHARITABLE LANDSCAPE OF LOUISIANA

The provisions governing charitable organizations operating in Louisiana are placed in Titles 12 and 51 of the Louisiana Revised Statutes.[8] State law governs the organization and regulation of charities, and many states enact such laws to regulate charitable organizations.[9] Similar to statutes governing for-profit corporations,[10] these regulations are necessary for charitable organizations seeking to operate legally in Louisiana.[11]

A. The Charitable Distinction

An important distinction exists between a nonprofit organization and a charity. The term "nonprofit" is a state law organizational concept, making an organization eligible for certain state law tax benefits.[12] If an

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7. *See infra* Part III.

8. LA. REV. STAT. ANN. §§ 12:201 to :275 (2010); LA. REV. STAT. ANN § 51 (2003, 2012, & Supp. 2015).

9. *See* Fishman, *supra* note 6, at 222; *see also* N.Y. NOT-FOR-PROFIT CORP. LAW § 35; CAL. CORP. CODE §§ 5001–10845.

10. *See* LA. REV. STAT. ANN. §§ 12:1-101 to 1-1704 (containing Louisiana's Business Corporation statutes) (Supp. 2015).

11. *See* LA. REV. STAT. ANN § 12:203 (setting forth the requirements to form a nonprofit corporation in Louisiana).

12. *Applying for Exemption – Difference Between Nonprofit and Tax-Exempt Status*, IRS, http://www.irs.gov/Charities-&-Non-Profits/Applying-for-Exemption-Difference-Between-Nonprofit-and-Tax-Exempt-Status [http://perma.cc/CBY3-SUSM] (last updated Mar. 4, 2015).

organization forms as a nonprofit at the state level, it will not automatically receive federal tax exemption status.[13] The Internal Revenue Service ("IRS") is responsible for granting tax-exemption status through a set of requirements that an applying organization must meet.[14]

Whereas a nonprofit is a state law status, the classification of "charity" is based on the IRS's determination that a nonprofit meets specific requirements for tax-exemption.[15] Section 501(c)(3) of the Internal Revenue Code states that an organization formed and operated for a charitable purpose will automatically receive tax-exemption from the IRS.[16] Additionally, the organization cannot benefit private interests, and net earnings of the organization cannot benefit private individuals.[17]

B. How is a Charity Formed?

Generally, a charity will form under its state's nonprofit corporation act, making it a specific type of nonprofit.[18] Charities may also form as charitable trusts.[19] Charitable organizations formed as neither trusts nor corporations are rare, and the law that applies to those types of organizations is vague and ambiguous, blurring the line of whether they truly fall under the definition of a charity.[20] In a similar fashion, the law that applies to charitable organizations is also poorly defined and has developed slowly in comparison to for-profit corporation law.[21]

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13. *Id.*
14. *Id.*
15. *See Types of Tax-Exempt Organizations*, IRS, http://www.irs.gov/Charities-&-Non-Profits/Types-of-Tax-Exempt-Organizations [http://perma.cc/7M76-QV4A] (last updated Jan. 15, 2015).
16. I.R.C. § 501(c)(3) (2012). A complete overview and analysis of the tax-exempt determination process is beyond the scope of this Comment. For an overview of this process, see Karen Donnelly, Comment, *Good Governance: Has the IRS Usurped the Business Judgment of Tax-Exempt Organizations in the Name of Transparency and Accountability?*, 79 UMKC L. REV. 163, 169–72 (2010).
17. *Exemption Requirements – 501(c)(3) Organizations*, IRS, http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Exemption-Requirements-Section-501(c)(3)-Organizations [http://perma.cc/TU9A-738D] (last updated Jan. 8, 2015). This Comment will refer exclusively to charitable organizations.
18. *See* Henry B. Hansmann, *Reforming Nonprofit Corporation Law*, 129 U. PA. L. REV. 497, 501–02 (1981); *see also* LA. REV. STAT. ANN. §§ 12:201 to 12:275 (2010) (containing the Louisiana Nonprofit Corporation Act).
19. Fishman, *supra* note 6, at 224; *see also* LA. REV. STAT. ANN. § 9:2271 (2009) (detailing trusts formed for charitable purposes).
20. *See* Hansmann, *supra* note 18, at 502. This Comment will focus on charitable organizations formed as either charitable trusts or corporations.
21. Jill R. Horwitz, *Why We Need the Independent Sector: The Behavior, Law, and Ethics of Not-for-Profit Hospitals*, 50 UCLA L. REV. 1345, 1377 (2003); *see also* MARION R. FREMONT-SMITH, GOVERNING NONPROFIT ORGANIZATIONS

C. Distinguishing For-Profits from Charities

Unlike for-profit corporations, where shareholders expect to share in profits earned by the corporation, owners of charitable organizations are prohibited from sharing simultaneously in both profits and control.[22] In Louisiana, the law prohibits an organization formed under the Nonprofit Corporation Law Act from distributing dividends or pecuniary remunerations to shareholders and also restrains members from retaining the organization's earnings.[23] Louisiana's regulations also define a charity as "a [juridical] person who is or holds himself out to be a benevolent, civic, recreational, educational, voluntary, health, law enforcement, social service, philanthropic, fraternal, humane, patriotic, religious, or eleemosynary organization."[24]

Charitable organizations are public-benefitting organizations in nature.[25] The charitable sector depends on the public's trust that charities will serve a public purpose.[26] The charitable sector's commitment to serve the public's needs distinguishes these types of organizations from for-profit organizations.[27]

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19 (2004) (stating that charitable law consists of trust law, corporate codes, federal and state tax laws, decedents' estates, and selections from property). Louisiana recently revised its business corporation statutes in 2014 to be effective January 1, 2015. *See* Glenn G. Morris, *Model Business Corporation Act as Adopted in Louisiana*, 75 LA. L. REV. 983, 983 (2015). The new model is based on the nationally-recognized Model Business Corporation Act. *Id.* A revision to the Nonprofit Corporation Act may also be forthcoming. However, the legislature has not passed any such revision at this time.

22. Hansmann, *supra* note 18, at 501.

23. LA. REV. STAT. ANN. § 12:210(F) (2010); *see also* LA. REV. STAT. ANN. § 12:266(1) (2010) (stating that the Nonprofit Corporation Law Act does not apply to "[a]ny corporation organized for any purpose involving pecuniary profit or gain to its shareholders or members, or which pays dividends or similar pecuniary remuneration.").

24. LA. REV. STAT. ANN. § 51:1901(1) (2010). An eleemosynary organization is one created for a dedicated charitable purpose or an organization which is supported by a charity. JAMES S. HOLLIDAY, JR., RICK J. NORMAN & DALE R. BARINGER, LOUISIANA CORPORATIONS, § 18:3, *in* 1 LOUISIANA PRACTICE SERIES 1222 (2014).

25. Lloyd Hitoshi Mayer & Brendan M. Wilson, *Regulating Charities in the Twenty-First Century: An Institutional Choice Analysis*, 85 CHI.-KENT L. REV. 479, 489 (2010). Louisiana defines *charity* under the Deceptive Practices in Soliciting Charitable Organizations chapter to set guidelines for these organizations in soliciting donors. *Id.*

26. *See id.*

27. *See* Joel L. Fleishman, *Public Trust in Not-for-Profit Organizations and the Need for Regulatory Reform*, *in* PHILANTHROPY AND THE NONPROFIT SECTOR IN A CHANGING AMERICA 172, 173 (Charles T. Clotfelter & Thomas Ehrlich eds., 1999).

D. Roles of Charitable Officers and Directors

Typically, charities have a self-perpetuating board of directors who control the organization.[28] Charity directors, like for-profit directors, appoint officers and executives responsible for running the organization on a day-to-day basis.[29] The directors of these boards are regarded as fiduciaries.[30] The Louisiana Revised Statutes state that officers and directors are fiduciaries and must act "in good faith, and with that diligence, care, judgment and skill which ordinary prudent men would exercise under similar circumstances in like positions."[31]

E. Fiduciary Obligations of Charity Directors

Fiduciary duties are standards of conduct that directors must follow while serving their organization.[32] Specifically, fiduciary duties require directors to act in a way that furthers the charitable organization's purpose and prohibits the directors from making self-benefitting decisions.[33] Because charitable organizations serve a public purpose, their directors are held to a higher standard of fiduciary obligations than their for-profit counterparts.[34] For example, a director acts out his or her fiduciary obligations by making informed and reasonable decisions that are in the best interest of the charitable organization.[35] If, however, directors continually miss meetings, make uninformed decisions, or use their positions for personal benefit, they have likely breached their fiduciary responsibilities.[36]

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28. FREMONT-SMITH, *supra* note 21, at 19. A self-perpetuating board of directors is a system where the out-going directors vote for their own replacements. *See* Ellis Carter, *Nonprofit Law Jargon Buster – Voting Members vs. Self-Perpetuating Boards*, CHARITY LAW. (Apr. 26, 2011), http://charitylawyerblog.com/2011/04/26/nonprofit-law-jargon-buster-voting-members-vs-self-perpetuating-boards/ [http://perma.cc/N2H4-W4VB].

29. *See* Brent Wilson, *Advising and Serving on Non-Profit Boards: No Good Deed Goes Unpunished*, 53 ADVOCATE, no. 9, Sept. 2010, at 39.

30. Hazen & Hazen, *supra* note 1, at 349; *see infra* Part I.D; *see also* LA. REV. STAT. ANN. § 12:201(11) (2010) (stating that *fiduciary* means "any person, firm, partnership, association or corporation, including a usufructuary, who or which occupies a position of peculiar confidence toward any person, firm, association, partnership, trust or estate").

31. LA. REV. STAT. ANN. § 12:226(A).

32. *See* Hazen & Hazen, *supra* note 1, at 355.

33. FREMONT-SMITH, *supra* note 21, at 187.

34. Hazen & Hazen, *supra* note 1, at 397.

35. JACK B. SIEGEL, A DESKTOP GUIDE FOR NONPROFIT DIRECTORS, OFFICERS, AND ADVISORS 80 (2006).

36. *Id.*

These examples of fiduciary duties translate into two main obligations: the duty of care and the duty of loyalty.[37]

1. The Duty of Care

The duty of care requires a director's actions to be the same as that of a normal, prudent person acting in a like position.[38] A director properly satisfies the duty of care by keeping informed of organizational activities, remaining attentive to the organization's operations, and making decisions that are in the best interest of the organization.[39] In the charitable context, directors must follow the duty of care when investing charitable assets and engaging in activities following the organization's charitable mission.[40] Directors have a wide range of latitude in exercising control; however, they are still required to make informed decisions with proper judgment.[41] For example, a breach of the duty of care occurs when a director uses dedicated charitable funds against a donor's wishes.[42]

The business judgment rule shields directors from liability for violating the duty of care if the director has acted as an ordinarily prudent administrator would under like circumstances.[43] Essentially, the business judgment rule is meant to protect directors from liability if they make informed business decisions.[44] Courts apply the business judgment rule because judges do not view their role as second guessing director decisions and holding directors liable for well-intentioned decisions that turned out poorly.[45]

A real-life example of a breach of the duty of care occurred when directors of the Allegheny Health Education and Research Foundation

37. Hazen & Hazen, *supra* note 1, at 355. A third duty, the duty of obedience, is often included, but the most commonly accepted duties are the duties of care and loyalty. *Id.* at 388. The duty of obedience captures the idea that a director is under an obligation to ensure that the corporation is acting within its stated purpose and mission. *Id.* The duty of obedience is a reflection of the age-old ultra vires doctrine that prohibits corporate acts that go beyond the corporation's mission and purpose. *Id.*

38. Evelyn Brody, *The Limits of Charity Fiduciary Law*, 57 MD. L. REV. 1400, 1420 (1998).

39. Hazen & Hazen, *supra* note 1, at 375.

40. FREMONT-SMITH, *supra* note 21, at 433.

41. *Id.*

42. *See* Hazen & Hazen, *supra* note 1, at 375–79.

43. Michael W. Peregrine & James R. Schwartz, *Revisiting the Duty of Care of the Nonprofit Director*, 36 J. HEALTH L. 183, 189–90 (2003).

44. Hazen & Hazen, *supra* note 1, at 376–77.

45. *Id.*

("AHERF") used restricted funds to repay bank loans.[46] AHERF liquidated money from endowment funds to pay back a bank loan of around $89 million.[47] The Pennsylvania Attorney General arrested three of the directors at AHERF and brought criminal charges for illegally spending money out of charitable endowment funds.[48] This example sheds light on to just one example of directors who breach the duty of care and who attempt to hide behind the business judgment rule.

2. The Duty of Loyalty

The duty of loyalty requires board members to place personal interests behind those of the charity and its mission[49] and sets standards for situations where a director has a conflict of interest.[50] Under the duty of loyalty, directors are prohibited from completing self-dealing transactions that benefit themselves over the organization.[51] A director can breach the duty of loyalty by disclosing confidential information, usurping a business opportunity from the charity, unlawfully distributing charitable assets, or using organizational funds for improper purposes.[52] A common example of a director breaching the duty of loyalty is "a director who serves on the boards of two charities that are looking for major gifts from a specific donor or are interested in purchasing a specific parcel of real estate."[53]

Examples of directors breaching their duty of loyalty are more prevalent than breaches of the duty of care. Another real life example is Oral Suer, a former director at the United Way of the National Capital

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46. Josh Goldstein & Karl Stark, *Allegheny Chief Ordered Fund Switch the Health System Used Restricted Money to Repay an $89 Million Bank Loan*, PHILLY.COM (Dec. 9, 1998), http://articles.philly.com/1998-12-09/news/25720088_1_allegheny-officials-allegheny-health-education-aherf [http://perma.cc/R8UJ-DW3C].

47. *Id.*

48. *Pennsylvania Attorney General Fisher Announces Arrests of Three AHERF Officers; Trio Charged with Illegally Spending $52 Million in Charitable Funds*, PR NEWSWIRE (Mar. 15, 1998), http://www.prnewswire.com/news-releases/pennsylvania-attorney-general-fisher-announces-arrests-of-three-aherf-officers-trio-charged-with-illegally-spending-52-million-in-charitable-funds-73105892.html [http://perma.cc/XA4N-4L3Y].

49. Christyne J. Vachon, *Blurring. Not Fading. Looking at the Duties of Care and Loyalty as Nonprofits Move into Commercialism*, 12 TRANSACTIONS: TENN. J. BUS. L. 37, 48 (2011).

50. Hazen & Hazen, *supra* note 1, at 381.

51. *Id.* at 381–82.

52. *See* Vachon, *supra* note 49, at 49.

53. FREMONT-SMITH, *supra* note 21, at 436.

Area in Washington D.C.[54] Suer defrauded the charity of roughly $500,000 for personal benefit.[55] A federal court forced Suer to pay $497,000 in restitution and serve the maximum sentence of 27 months in prison.[56] When directors breach these duties, the harmful impact extends beyond the charity and affects the public and the charity's intended beneficiaries.

II. Overview and Analysis of the Current Charitable Enforcement Model

The oversight of charitable organizations is crucial because charities exist to provide a public benefit.[57] Commenting on the state of charitable oversight, Professor Terri Lynn Helge has stated: "Substantial reform in the regulation of charitable organizations is necessary to curb the reported abuses that have undermined confidence in the charitable sector."[58] Effective regulation of the charitable sector warrants proper oversight that assures the public that these organizations are following an accepted set of standards by which society has agreed these entities should abide.[59]

A. The Need for Proper Oversight in the Charitable Sector

A major reason why the government and the general public allow tax-exempt organizations to exist is because the organizations serve their community in some way.[60] When charities abuse their privileges, the public will lose faith in the entire sector.[61] Wrongdoing in the charitable sector is due in part to the lack of standardization of good governance principals and improper or insufficient oversight from enforcement officials.[62]

Scandals at large charitable organizations further demonstrate this problem and the need for charitable oversight reform. In the aftermath of the September 11 terrorist attacks, the American Red Cross used donations for purposes other than victim support, sparking controversy in the media

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54. Jerry Markon, *Ex-Chief of Local United Way Sentenced*, WASH. POST (May 15, 2004), http://www.washingtonpost.com/wp-dyn/articles/A27261-2004May14.html [http://perma.cc/5Z2W-Z9DE].
55. *Id.*
56. *Id.*
57. *See* Fishman, *supra* note 6, at 255–56.
58. Terri Lynn Helge, *Policing the Good Guys: Regulation of the Charitable Sector Through a Federal Charity Oversight Board*, 19 CORNELL J.L. & PUB. POL'Y 1, 1 (2009).
59. Mayer & Wilson, *supra* note 25, at 489.
60. *See* Fishman, *supra* note 6, at 220.
61. *Id.*
62. Hazen & Hazen, *supra* note 1, at 362.

and public.[63] Another example is a board member at the Smithsonian Institute who resigned amid allegations of excessive salaries, enormous expense accounts, and personal trips funded by the museum in 2007.[64]

Classifying scandals in the charitable sector as outliers is tempting.[65] Some truth to this idea may exist, as the precise extent of wrongdoing in the charitable sector is difficult to determine.[66] These examples are not alone, as there are many more cases of indecency both reported and unreported.[67] Scandals such as these illustrate the fact that the problem extends beyond isolated incidents and the need for reform across the charitable spectrum.

B. Director and Organization Accountability in Different Business Sectors

In comparison to the charitable sector, the for-profit sector has more means of accountability and greater oversight of organizations and directors.[68] During the past decade, the federal government has reformed for-profit corporate governance and heightened the accountability standards of corporate directors.[69]

The traditional corporate accountability model relies on oversight from the company's shareholders.[70] Shareholders have standing to bring suit against directors and officers of the corporation for violations of

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63. *See* Roger Colinvaux, *Charity in the 21st Century: Trending Toward Decay*, 11 FLA. TAX REV. 1, 20–21 (2011) (stating that "the fallout was considerable, and contributed to an erosion of confidence in charities, later reinforced by continuing press reports of scandals in the sector").

64. Jacqueline Trescott & James V. Grimaldi, *Smithsonian's Small Quits in Wake of Inquiry*, WASH. POST, Mar. 27, 2007, at A1.

65. *See* Colinvaux, *supra* note 63, at 19.

66. *See* FREMONT-SMITH, *supra* note 21, at 13–14. The author cites a study of nonprofit corruption between 1995 and 2002 that showed 152 instances of nonprofit directors accused of either criminal or civil wrongdoing. *Id.* Yet, at the same time there were an estimated 1.4 million nonprofit organizations operating in the United States. *Id.* This data most likely suggests serious underreporting and a lack of oversight in the sector as a whole. *Id.*

67. *See Charity Watch Hall of Shame*, CHARITY WATCH, https://www.charitywatch.org/charitywatch-articles/charitywatch-hall-of-shame/63 [https://perma.cc/GZ7D-9J2F] (last visited Sept. 21, 2015) (chronicling charity directors involved in major charity scandals throughout the 21st century).

68. *See generally* Hazen & Hazen, *supra* note 1, at 358–60 (describing the increased reforms that have taken place in corporate governance).

69. *Id.* at 357.

70. ELIZABETH SARAH GERE, PAUL C. VITRANO & STEPHANIE T. SCHMELZ, BE PREPARED: NON-PROFIT ORGANIZATIONS' LEGAL RISKS AND PROTECTIONS 10 (2005), *available at* http://www.altru.com/resources/Altru_LiabilityExposureUpdate.pdf [http://perma.cc/79CD-GWBS].

fiduciary obligations.[71] These suits, called derivative actions, can be an effective tool to hold directors accountable in situations of director self-dealing and other instances of breaches of the duty of loyalty.[72]

The Division of Enforcement of the Securities and Exchange Commission ("SEC") also plays a role in governing for-profit corporations. The SEC seeks to monitor "[c]ompanies offering securities for sale to the public[,] . . . the securities they are selling, and the risks involved in investing in those securities."[73] The primary function of SEC oversight is to "regulat[e] brokers, investment advisors, mutual funds, and market operators."[74] The enforcement staff, composed of roughly 250 attorneys and other professionals, conduct informal and formal inquiries into possible securities violations and if violations are discovered, the attorneys impose sanctions on the transgressor.[75] Federal securities law allows the SEC to institute injunctive proceedings, civil penalties or fines, cease-and-desist orders, or proceedings directly against securities professionals.[76]

The Sarbanes–Oxley Act of 2002,[77] which Congress passed in hopes of building public confidence in corporations and to provide better oversight of these organizations, is another tool for overseeing for-profit corporations.[78] The Act initiated various governance reforms in the corporate sphere.[79] Congress limited the Act to for-profit corporations, however, and it is not applicable to charitable organizations.[80]

Another model used to protect the public from for-profit director duty breaches is the Financial Industry Regulatory Authority ("FINRA").[81] FINRA is a government-authorized nonprofit organization dedicated to

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71. *Id.*

72. Anne Tucker Nees, *Who's the Boss? Unmasking Oversight Liability Within the Corporate Power Puzzle*, 35 DEL. J. CORP. L. 199, 214 (2010).

73. U.S. Sec. & Exchange Comm'n, *The Role of the SEC*, INVESTOR.GOV, http://investor.gov/introduction-markets/role-sec#.VFFhH_nF98E [http://perma.cc/42ZB-LVNE] (last visited Sept. 1, 2015).

74. Peter J. Henning, *Should the SEC Spin Off the Enforcement Division?*, 11 TRANSACTIONS: TENN. J. BUS. L. 121, 123 (2009).

75. *See* Ralph C. Ferrara & Philip S. Khinda, *SEC Enforcement Proceedings: Strategic Considerations for When the Agency Comes Calling*, 51 ADMIN. L. REV. 1143, 1145 (1999).

76. *Id.* at 1173.

77. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified as amended in scattered sections of 11, 15, 28, and 29 U.S.C.).

78. Eric M. Fogel, David I. Addis & Edward C. Harris, *Public Company Shareholders Acting as Owners: Three Reforms—Introducing the "Oversight Shareholder"*, 29 DEL. J. CORP. L. 517, 519 (2004).

79. Hazen & Hazen, *supra* note 1, at 358.

80. *Id.*

81. *About FINRA*, FINRA, http://www.finra.org/AboutFINRA/ [http://perma.cc/TKN9-7DT7] (last visited Sept. 2, 2015).

ensuring that the securities industry operates correctly and honestly.[82] FINRA regulates all securities firms who conduct business with the public, overseeing approximately 633,000 registered security representatives.[83] FINRA enforces federal securities laws, its own set of standards, and rules that the Municipal Securities Rulemaking Board has put in place.[84] FINRA is also authorized to discipline securities dealers who violate regulations by leveling fines and barring brokers from the securities industry.[85]

Overall, there is much more oversight of for-profit, public organizations than charitable organizations because the public is more financially invested in for-profit organizations, and misdoings in the for-profit sector have a broad range of consequences for the public.[86] While the government has taken a proactive role in regulating for-profit corporations, changes to the charitable regulation scheme have been slow to develop.

C. Charitable Enforcement through the State Attorney General

In most states, the attorney general supervises the charitable sector by monitoring funds donated to public charities and preventing these charities from misappropriating donated funds.[87] The attorney general acts as the representative of charity beneficiaries and donors of charitable organizations in this way.[88] State attorneys general have the exclusive

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82. *Id.*
83. Jonathan Macey & Caroline Novogrod, *Enforcing Self-Regulatory Organization's Penalties and the Nature of Self-Regulation*, 40 HOFSTRA L. REV. 963, 968–69 (2012).
84. *What We Do*, FINRA, http://www.finra.org/AboutFINRA/WhatWeDo/ [http://perma.cc/FMJ4-YB24] (last visited Sept. 2, 2015).
85. *Id.*
86. Reforms of for-profit corporate governance took place in part because of corporate fraud during the Enron era and the financial collapse of 2008. Hazen & Hazen, *supra* note 1, at 358. These events caused public and governmental concern over corporate governance policies and the duties of corporate directors. *Id.* The majority of the reforms mentioned above, however, were limited to publicly traded, for-profit corporations. *Id.*
87. FREMONT-SMITH, *supra* note 21, at 305–06. The state attorney general is an external enforcer of charitable organizations, but scholars have suggested a number of internal actions charitable organizations should take to avoid liability. SIEGEL, *supra* note 35, at 491–600. These internal controls provide oversight to help directors and managers avoid operational liabilities. Internal controls are a first defense against director and organizational misconduct. A complete discussion of these controls is outside the scope of this Comment. For an overview of a charity's internal controls, see *id.*
88. FREMONT-SMITH, *supra* note 21, at 443.

authority to enforce fiduciary obligations in most states and proper oversight of the charitable sector falls firmly on their shoulders.[89]

State attorneys general's offices require charities to register with their office, file annual informational reports, and provide copies of federal informational returns and audited financial statements.[90] Attorneys general can then file suit against these organizations to correct violations of charitable law,[91] and have the power to remove directors, dissolve violating organizations, or request an accounting of charitable assets.[92] In most states, the attorney general is also responsible for charitable solicitation "to protect . . . donors from deceptive and fraudulent solicitation practices or diversion or waste of donated funds."[93] However, one drawback is the fact that attorneys general do not have the power to monitor charities in their day-to-day operations.[94]

D. Regulation of Charities through the IRS

The IRS is responsible for enforcing federal tax law on charitable organizations.[95] In 2004, amidst ongoing scandals in the charitable sector,[96] Mark W. Everson, the then-commissioner of the IRS, testified in front of the U.S. Senate Finance Committee about the IRS's plans to implement more thorough oversight of the sector.[97] Commissioner Everson spoke about the problems in the sector including ethical violations, the lack of internal oversight measures, and conflicts of interest among directors.[98] In light of these problems, Commissioner Everson proposed a plan to increase oversight of charitable organizations that included imposing penalties on violating organizations and increased review of the Form 990.[99] The Form 990 is an annual reporting form that all charitable organizations must file with the IRS,[100] mirroring an audited financial statement.[101] Commissioner Everson stated that the IRS was going to switch from a passive to active role

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89. Helge, *supra* note 58, at 13.
90. *Id.* at 14. Charitable organizations may be required to have an audited financial statement prepared by a certified public accountant. Donnelly, *supra* note 16, at 170.
91. Fishman, *supra* note 6, at 260.
92. *Id.*
93. *Id.* at 261–62.
94. *Id.* at 262.
95. Mayer & Wilson, *supra* note 25, at 498.
96. *See supra* Part II.B.
97. Donnelly, *supra* note 16, at 179.
98. *Id.*
99. *Id.*
100. *Id.* at 165.
101. Fishman, *supra* note 6, at 241.

to prevent charitable organization scandals from unfolding, stating that continued abuse "would no longer be tolerated."[102]

The Form 990 was recently revised with a new version released for filings beginning in 2009.[103] The new form poses questions designed to elicit the policies and practices in place of the filing charity's governance structure.[104] The revised form also aims to increase transparency of director compensation and involvement.[105] The filing of the Form 990 must include "the process by which the officers, directors, trustees, or management reviewed the form, whether the form was reviewed before it was filed with the IRS, who conducted the review, when it was conducted, and the extent of the review."[106] A new section titled "Governance, Management, and Disclosure" requires detailed answers about the charity's governing board and management practices.[107]

Noncompliance with the items in the new Form 990 "will, at a minimum, raise a red flag and could trigger an investigation or an audit risk."[108] The ultimate penalty that an organization can receive for violating IRS regulations is the loss of tax-exempt status.[109] No federal law grants the IRS the power to regulate charitable governance, however; charities have the right to reject IRS recommendations.[110] The Form 990 disclosures do not specifically require that charities follow a set of good governance standards; however, they are "designed to strongly encourage transparency and accountability."[111] Additionally, as one commentator noted, "the questions asked on the new form will not necessarily reflect the effectiveness or the efficiency with which a board of any size operates."[112]

102. Donnelly, *supra* note 16, at 179–180.
103. *Id.*
104. *Id.* at 181.
105. Hazen & Hazen, *supra* note 1, at 367–68 ("The Form 990 must also indicate whether the process for determining the compensation for the CEO, key officers and key employees included a review and approval by independent persons, consideration of compensation data for comparable positions at similar organizations, and contemporaneous documentation of deliberations and decisions regarding compensation.").
106. *Id.* at 367.
107. Donnelly, *supra* note 16, at 183.
108. *Id.* at 188.
109. Hazen & Hazen, *supra* note 1, at 368.
110. Donnelly, *supra* note 16, at 188.
111. Hazen & Hazen, *supra* note 1, at 397.
112. Donnelly, *supra* note 16, at 184.

E. Watchdog Oversight of the Charitable Sector

Independent watchdog organizations also monitor and provide oversight of the charitable sector.[113] Watchdog organizations use a system of evaluations and ratings based on charities' public 990 filings.[114] Watchdog focus groups typically use a rating system to evaluate how a particular charity uses donor funds.[115] Watchdog organizations can give lower grades based on a charity's reporting, which may "cause donors to look past that particular charity in favor of other, higher-ranking organizations."[116]

These organizations serve an important part in enforcing fiduciary standards, but they are no substitute for official enforcement procedures that hold charities accountable.[117] Charities have no obligation to report to these organizations and their oversight is limited to informal investigations and whatever information can be discerned from a charity's Form 990.

F. Charitable Enforcement in Louisiana

In Louisiana, the Office of the Attorney General is responsible for monitoring and assisting charitable organizations operating in the state, although there is no express statutory authority granting this responsibility.[118] The only writing that delegates or references the Attorney General's duty to oversee charitable organizations is found on their official website, which states that it will "assist [donors] with how to make a wise charitable donation and . . . assist charitable organizations . . . with their legal obligations"[119]

Title 51 of the Louisiana Revised Statutes holds the Trade and Commerce protection statutes in Louisiana.[120] Chapter 24, the Deceptive Practices in Soliciting Charitable Contributions section, gives the Louisiana Attorney General the power to prosecute charitable organizations that "engage in unfair methods of competition, unfair or deceptive practices, or

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113. *Id.* at 167.
114. *Id.*
115. Helge, *supra* note 58, at 61–62; *see also Criteria & Methodology*, CHARITY WATCH, https://www.charitywatch.org/charitywatch-criteria-methodology [perma.cc/6GZH-GTDF] (last visited Sept. 2, 2015) (providing an overview of how Charity Watch, a charitable watchdog organization, rates and grades charities based on different criteria and factors).
116. Donnelly, *supra* note 16, at 191.
117. *See* Fleishman, *supra* note 27, at 185.
118. *Charities*, OFF. ATT'Y GEN. STATE LA., https://www.ag.state.la.us/Article.aspx?articleID=3&catID=0 [https://perma.cc/P3DM-A9N6] (last visited Sept. 2, 2015).
119. *Id.*
120. LA. REV. STAT. ANN. § 51 (2012).

misrepresentation."[121] The Consumer Protection Section ("CPS") of the attorney general's office issues Civil Investigative Demands ("CIDs") against charities suspected of engaging in prohibited practices.[122] Based on information obtained through a CID, the CPS will decide whether to take disciplinary actions against the alleged wrongdoer. Though the attorney general may file suit, the majority of proceedings filed against charitable organizations are settled before charges are even filed.[123]

G. Limitations and Restrictions on the State Attorney General's Oversight in the Charitable Sector

State attorneys general face severe limitations that prevent them from proper oversight of the charitable sector.[124] Enforcement through the attorney general's office is limited, particularly in correcting violations of duties of care and loyalty and ensuring that charitable funds are properly allocated.[125]

Many attorney general offices face staffing problems and inadequate funding, which complicates enforcement efforts.[126] A survey conducted in 2007 revealed that 74% of states had only one or fewer full-time attorneys dedicated to charitable oversight, even as the number of charitable organizations has more than doubled in the past 15 years.[127] This lack of

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121. LA. REV. STAT. ANN. § 51:1905(A) (2012). The entire section states:

> It shall be unlawful for any charitable organization, solicitor therefor, or person owning, managing, directing, representing, or acting as agent for any charitable organization, an organization soliciting contributions for any charitable organization, or an organization claiming to sell merchandise, products, goods, or services for charitable purposes to engage in unfair methods of competition, unfair or deceptive practices, or misrepresentation.

Id.

122. LA. REV. STAT. ANN. § 51:1411 (Supp. 2015). A CID is a written request for information from an attorney general's office. Peter A. Nolan, *Yes, You Do Need to Respond to Civil Investigative Demands*, METRO. CORP. COUNS. (Sept. 1, 2007), http://www.metrocorpcounsel.com/articles/8820/yes-you-do-need-respond-civil-investigative-demands [http://perma.cc/PC59-XYTD]. The purpose of a CID is to collect information in a similar fashion to the pre-trial discovery phase. *Id.* The state attorney general uses CIDs to gather information pursuant to an investigation of alleged wrongdoing. *Id.*

123. *See generally* FREMONT-SMITH, *supra* note 21, at 446 (stating that attorneys general have increasingly used the threat of litigation to make charities agree to settlements).

124. Hazen & Hazen, *supra* note 1, at 402–03.

125. FREMONT-SMITH, *supra* note 21, at 443.

126. *Id.* at 445.

127. Garry W. Jenkins, *Incorporation Choice, Uniformity, and the Reform of Nonprofit State Law*, 41 GA. L. REV. 1113, 1128 (2007); *Number of Nonprofit Organizations in the United States, 1999–2009*, NCCS, http://nccsdataweb.urban.org

staffing and resources also contributes to a lack of information flowing from oversight officials to legislatures considering new laws.[128] Attorney general offices are also self-sustaining through administrative fees, legislative appropriations, and fines and settlement awards collected from violating organizations. [129] Louisiana's registration fee is relatively low at $25 per year, as compared to other states' registration scaled fee systems based on the charity's size and contributions made to the organization.[130] California, for instance, has a scaling registration fee between $25 and $300, depending on the organization's revenue.[131]

Another major impediment to attorney general oversight is the politicization of attorney general offices.[132] Because attorneys general are elected officials, scholars have criticized their enforcement efforts for being politically biased.[133] For example, state attorneys general have occasionally attempted to block the relocation of charities to keep donations within their state.[134] State attorneys general may be reluctant "to move in an aggressive and timely fashion when to do so might be politically difficult—despite abundant grounds for concern about damage to the public interest."[135]

Centralization and standardization is another obstacle in holding charities accountable. This problem is partially due to the excessive

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/PubApps/profile1.php?state=US [http://perma.cc/U7HA-WAPA] (last visited Sept. 1, 2015).

128. Jenkins, *supra* note 127, at 1129–30.

129. Fishman, *supra* note 6, at 263.

130. *Charitable Registrations*, LA. DEP'T JUSTICE OFFICE ATT'Y GEN., https://www.ag.state.la.us/Shared/ViewDoc.aspx?Type=3&Doc=396 [https://perma.cc/QFK9-ZKJW] (last visited Sept. 2, 2015).

131. *See* Office of the Att'y Gen., *New Charity Registration Requirements and Fees*, STATE CAL. DEP'T JUSTICE, http://oag.ca.gov/charities/content/reg_req [http://perma.cc/8LR5-NBS4] (last visited Sept. 2, 2015); N.J. Div. of Consumer Affairs, *Charities Registration Section*, STATE N.J., http://www.njconsumeraffairs.gov/charities/Pages/registration.aspx [http://perma.cc/DP47-HPV5] (last updated Apr. 9, 2015, 8:48 AM) (having fees ranging from $60 to $250, depending on gross contributions); Or. Dep't of Justice, Form CT-12F (2014), *available at* http://www.doj.state.or.us/charigroup/pdf/2014_web_ct-12f.pdf [http://perma.cc/A9PH-459K] (fees ranging from $10 to $200 dependent on annual revenue); N.Y. Office of the Att'y Gen., Form CHAR500 (2014), *available at* http://www.charitiesnys.com/pdfs/CHAR500_2014.pdf [http://perma.cc/69NT-AZ9A] (annual registration fees ranging from $0 to $1500 dependent on the organization's net worth).

132. FREMONT-SMITH, *supra* note 21, at 446.

133. *See* Mayer & Wilson, *supra* note 25, at 494 (suggesting that an attorney general's motivation for enforcing fiduciary standards could be political rather than effective enforcement concerns).

134. *Id.* at 548.

135. Norman I. Silber, *Nonprofit Interjurisdictionality*, 80 CHI.-KENT L. REV. 613, 617 (2005).

number of regulators who all have different methods and levels of enforcement.[136] Scholars have noted "the increasing overlap in enforcement jurisdictions of the state attorneys general and the IRS" have resulted in "inefficiencies in the regulation of the [charitable] sector."[137] The result has been a "pass-the-ball" game in which both entities believe the other one will handle regulation, which results in no enforcement at all.[138]

Another challenge facing Louisiana's attorney general oversight is the fact that only charities using professional solicitors are required to register with the office.[139] The Louisiana Attorney General does not keep records of charities operating in the state that do not use professional solicitors.[140] State attorneys general cannot properly regulate charities if they records of their operation do not exist.[141]

H. Standing to Sue in the Charitable Arena

In addition to the lack of proper oversight, standing challenges often complicate suits to enforce director fiduciary obligations.[142] In for-profit corporations, shareholders have standing to bring suit against directors and officers for violating their fiduciary obligations.[143] Charitable organizations, on the other hand, do not have shareholders; thus, only a limited number of persons have standing to bring suits directly against directors for violations.[144] Courts have found that only fellow officers and directors, state attorneys general, and individuals with special relationships to the charity have standing to sue.[145] Complicating the standing issue is the fact that many courts have set high standing requirements for persons to sue in the charitable sector.[146]

In Louisiana, however, no restrictions prevent a charitable corporation from having shareholders; the restrictions only prohibit corporations from distributing profits or earnings to these shareholders.[147] Yet no decisions

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136. *See generally* Helge, *supra* note 58, at 79–80 (stating the inefficiencies resulting from multiple regulatory enforcement powers).
137. *Id.* at 79.
138. *Id.* at 80.
139. *Charities*, *supra* note 118. A professional solicitor is "any person who, for financial consideration, solicits contributions for or on behalf of a charitable organization, whether such solicitation is performed personally or through agents, servants, or employees or through agents engaged in the solicitation of contributions under the directions of such person." LA. REV. STAT. ANN. § 51:1901(6) (2012).
140. FREMONT-SMITH, *supra* note 21, at 444.
141. *Id.* at 445.
142. GERE ET AL., *supra* note 70.
143. *Id.*
144. *Id.*
145. *Id.*
146. *Id.*
147. LA. REV. STAT. ANN. § 12:201 (2010).

have been reported in Louisiana of a shareholder bringing a derivative suit against a charity's directors, and courts have not declared whether the shareholder would have standing in this situation. As demonstrated, there are a plethora of challenges facing regulation of the charitable sector. There are many scholars that recognize that a change is needed, but the debate is ongoing as to which solution is the best to effectuate that change.

III. SCHOLARLY PROPOSALS FOR IMPROVEMENT TO OVERSIGHT

Commentators have long criticized attorneys general as ill equipped to properly monitor charitable organizations.[148] Often, rumors will circulate of alleged wrongdoing without a formal investigation from the attorney general office.[149] Scholars have criticized this enforcement model for over 50 years and have proposed a variety of new models that better ensure oversight of the charitable sector.[150]

A. New State Agency

Professor Kenneth L. Karst gave one of the first proposals for change in charitable oversight in the 1960s.[151] He suggested a new state agency responsible "for supervising private charities and for administering the various state controls over their operations."[152] Under this proposal, each state would have its own independent agency responsible for charitable oversight and enforcing fiduciary obligations of directors.[153] The agency would collect periodic reports from charitable organizations to provide transparency of organizations operating in its state.[154] Professor Karst believed that a new agency was advantageous as compared to the current model because it would create a unified central administration system of the charitable sector and also include experts, such as accountants, specifically trained to audit and investigate charities.[155] Professor Karst thought that directors and managers of charitable organizations would also

148. Fleishman, *supra* note 27, at 185–86.
149. *Id.* at 187.
150. *See* Kenneth L. Karst, *The Efficiency of the Charitable Dollar: An Unfulfilled State Responsibility*, 73 HARV. L. REV. 433 (1960) (proposing a new model of charitable fiduciary enforcement in 1960); *see also* Mayer & Wilson, *supra* note 25, at 494 (finding that for more than 50 years scholars have expressed concerns over the current enforcement model).
151. Karst, *supra* note 150, at 476.
152. *Id.*
153. Mayer & Wilson, *supra* note 25, at 496.
154. *See* Karst, *supra* note 150, at 476–77 (listing the functions of the new proposed charitable accountability agency).
155. *Id.* at 477.

benefit from this system because the system would standardize reporting and oversight under one state agency.[156] He also believed that a unified agency would have the capacity to provide assessments of the charitable landscape to make proposals to the state's legislature for new regulations.[157]

Issues with forming a new state agency to regulate the charitable sector do exist, however. One issue is state hesitation of withdrawing charitable oversight from state attorneys general and handing such a task over to a new, inexperienced agency.[158] Further, state budgetary constraints would likely make this option almost impossible to implement.[159] Many states struggle with budgetary constraints and the public may see a new agency as an improper use of state funds when there is already an oversight system in place.[160] Another issue is coordinating the new state agency with other states and the federal regulatory agencies responsible for charitable oversight.[161]

B. State Charity Commission Working in Conjunction with the State Attorney General

In 2003, Professor James Fishman proposed a state charity commission to regulate a state's charitable sector that would work in conjunction with the state's attorney general.[162] Under this model, an assistant from the attorney general's office would manage a delegation of 15 people—7 appointed by the state attorney general and 8 appointed by the governor—responsible for oversight of the state's charitable organizations.[163] The commission would have exclusive authority over the charitable sector, including the power to investigate complaints made against organizations.[164] Under the new model, when a complaint is filed against a charity, a panel consisting of three randomly selected commissioners would investigate the complaint and, if validated, serve a copy of the complaint on the charity.[165] The panel would have the authority to settle or resolve the issue or, if

156. *Id*.
157. *Id.*
158. *See* Mayer & Wilson, *supra* note 25, at 518–19 (finding that a new state agency could result in governmental waste because the state attorneys general's offices already have experience in the area in every state).
159. For an understanding of state budgetary constraints, see Janet Loehrke et al., *Best- and Worst-Run States: Survey of All 50*, USA TODAY (Nov. 23, 2013, 2:39 PM), http://www.usatoday.com/story/money/business/2013/11/22/best-worst-run-states/3671359/ [http://perma.cc/Y8G5-NZPT].
160. *See id.*
161. Mayer & Wilson, *supra* note 25, at 541–45.
162. Fishman, *supra* note 6, at 272.
163. *Id.* at 272–73.
164. *Id.* at 273–74.
165. Mayer & Wilson, *supra* note 25, at 497.

necessary, bring the matter in front of the entire commission for review.[166] Professor Fishman argued that this system would strengthen oversight of the sector because the commission would be a remedial body capable of correcting fiduciary behavior.[167] He also believed that the new system would keep citizens interested in charitable oversight.[168]

The aforementioned problems with oversight by the attorney general, such as politicization, would likely also be present in a commission having strong ties to the office, however.[169] Another issue would arise if some states adopted the proposal and others did not.[170] Budgetary constraints could also affect this model because no reason exists to believe that a new state commission would receive any more funding than the attorney general's office.[171]

C. Federal Regulatory Commission

In 1999, Professor Joel Fleishman proposed a federal regulatory agency, called the U.S. Charities Regulatory Commission, which would be responsible for regulating and overseeing charitable organizations.[172] Under this model, the President would appoint commissioners responsible for regulating all nonprofit organizations.[173] Professor Fleishman believed the commission could model the Federal Trade Commission or the Securities and Exchange Commission.[174] The commission would handle investigations of alleged fiduciary breaches and also have the power to commence civil or criminal proceedings when violations were discovered.[175] Further, the new commission would "be empowered to investigate instances of wrongdoing, subpoena witnesses, and institute civil or criminal proceedings on its own motion."[176] The IRS would remain in charge of all tax-related issues, but work in conjunction with the commission to regulate the sector.[177] This approach would allow the IRS to focus on enforcing federal tax law and leave the new commission to monitor wrongdoing in the charitable sector.[178] Professor

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166. *Id.*
167. Fishman, *supra* note 6, at 273.
168. *Id.*
169. *See supra* Part II.A.
170. Mayer & Wilson, *supra* note 25, at 520. The concern is that charities operating in more than one state would face different rules and regulations in each state. *Id.*
171. *Id.*
172. *Id.* at 498–99.
173. Fleishman, *supra* note 27, at 189.
174. *Id.*
175. *Id.*
176. Mayer & Wilson, *supra* note 25, at 499.
177. Fleishman, *supra* note 27, at 189.
178. Mayer & Wilson, *supra* note 25, at 499.

Fleishman also suggested that that the commission should defer to state enforcement procedures to promote comity and a working relationship between the new commission and state enforcement officials.[179]

Even Professor Fleishman acknowledged, however, that mass reorganization and drastic changes to regulation of the nonprofit sector should not be the first solution.[180] He believed it should be a last resort, as charitable organizations would face significant changes and transition costs.[181] Another issue facing a new federal commission is the fact that Congress cannot compel a state to adopt a federally enforced set of fiduciary standards.[182] Professor Fleishman also worried about the commission's effectiveness in the face of political partisanship or a lack of funding.[183]

D. Exclusive Regulation by the IRS

Several scholars and government officials have suggested that the IRS would be the perfect organization to regulate the entire charitable sector.[184] Specifically, former Congresswoman Bonnie S. Brier suggested that the IRS could develop a list of recommended good governance standards that charitable organizations should adopt.[185] Congresswoman Brier believed that organizations would automatically adopt these standards to retain tax-exempt status.[186] Additionally, Congress could empower the IRS to condition tax-exemption status on an organization following fiduciary

179. Fleishman, *supra* note 27, at 190–91.

180. *Id.* at 186–87. Fleishman actually proposed three options and stated of the federal agency: "The third strategy—a new federal agency—is a strategy of last resort, which should be pursued only after it became clear that, for whatever reason, the two prior strategies cannot be made to work." *Id.* at 187. Professor Fleishman's first proposal was for a non-governmental accountability agency. *Id.* at 186–87. His second proposal was for a joint nonprofit–governmental run agency. *Id.* at 187.

181. Mayer & Wilson, *supra* note 25, at 521.

182. *Id.* at 522; *see also* New York v. United States, 505 U.S. 144, 188 (1992) (holding that the federal government cannot compel states to institute a federal regulatory agency). The federal government, however, uses incentives, such as funding, to entice states into adopting standards and programs that they create. *Id.* at 166.

183. Fleishman, *supra* note 27, at 190.

184. *See* Bonnie S. Brier et al., *The Appropriate Role of the Internal Revenue Service with Respect to Tax-Exempt Organization Good Governance Issues*, *in* ADVISORY COMM. ON TAX EXEMPT AND GOV'T ENTITIES (ACT), REPORT OF RECOMMENDATIONS (2008), *available at* http://www.irs.gov/pub/irs-tege/tege_act_rpt7.pdf [http://perma.cc/D2MN-XBTD]; FREMONT-SMITH, *supra* note 21, at 465–66.

185. *See id.* at 175.

186. *Id.*

standards.[187] Further, scholars have suggested giving the IRS the power to remove fiduciaries they find unfit to serve as leaders of charitable organizations.[188] In this sense, the IRS could possibly work with Congress to provide a single set of federal standards that all nonprofits across the United States would have to follow.[189]

Uncertainty persists, however, in allowing the IRS to take on this additional responsibility. The IRS lacks, and has only slowly developed, experience in charitable governance.[190] Further, the IRS may not be proficient in deciding whether a set of governance standards will actually "improve compliance with fiduciary duties by charity leaders."[191] Another concern is how coordination would take place between the IRS and state oversight.[192] The recent scandals uncovered at the IRS may also bring hesitation from Congress and the American people to hand over more power to the IRS.[193]

E. Expanding Standing in Charitable Director Suits

In 1999, Professor Geoffrey Manne argued that expanding standing to private actors could help regulate the sector more effectively than government regulation.[194] Professor Manne argued for creating private, for-profit organizations that would monitor charities and bring suits against violators, with the expectation that these monitoring organizations would successfully curb charitable and director actions to meet fiduciary obligations.[195] New legislation would require all charitable organizations to contract with one of these organizations to monitor their charitable operations.[196] The contract would give the monitoring organization the right

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187. Mayer & Wilson, *supra* note 25, at 524.
188. *See* Marion R. Fremont-Smith, *The Search for Greater Accountability of Nonprofit Organizations: Recent Legal Developments and Proposals for Change*, 76 FORDHAM L. REV. 609, 643 (2007) (suggesting that expanded IRS oversight could include the power to remove fiduciaries).
189. Mayer & Wilson, *supra* note 25, at 522.
190. *Id.*
191. *Id.* at 523.
192. *See id.* at 524 ("Would the IRS have to go to state court to determine if a fiduciary duty violation had occurred? What happens if the IRS on its own determines such a violation has occurred but a later state court or [attorney general] decision says it had not?").
193. *See generally IRS Tea Party Scandal*, HUFFINGTON POST, http://www.huffingtonpost.com/news/irs-tea-party-scandal/ [http://perma.cc/CCT5-97WL] (last visited Sept. 1, 2015) (containing articles related to the IRS Tea Party scandal).
194. Geoffrey A. Manne, *Agency Costs and the Oversight of Charitable Organizations*, 1999 WIS. L. REV. 227, 253.
195. Mayer & Wilson, *supra* note 25, at 502.
196. *Id.*

to sue the charity for violating its charitable mission or in situations where directors have breached their fiduciary obligations.[197] Professor Manne argued that this model would improve accountability within the sector without subjecting charitable organizations to frivolous public lawsuits, while also reducing government oversight costs.[198]

Concern over the financial incentives and enforcement motivations of the new oversight organizations would likely arise. Many charitable organizations could simply choose to refrain from entering a relationship with a monitoring company because of budget constraints.[199] The monitoring companies may avoid proper oversight to retain more charities as clients.[200] Without proper oversight of the newly created monitoring companies, the risk of collusion between the monitoring company and a charity could be unchecked.[201]

F. Self-Regulatory Organization

Marcus Owens, a former director of the IRS's Exempt Organizations Division, proposed a unique model of charitable oversight where a self-regulatory organization would be responsible for charitable corporate governance oversight.[202] The "organization would have the authority to promulgate rules applicable to charitable organizations[,] . . . process applications for exemptions, and conduct oversight of the charitable sector through examinations."[203] Owens' proposal would be modeled after the SEC and the National Association of Securities Dealers ("NASD").[204] He believed that Congress could charter the tax-exempt oversight organization with funding coming from the excise tax levied against charitable organizations.[205] As a condition for receiving tax-exempt status from the IRS, the organization would be required to register under the new oversight board for monitoring.[206]

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197. *Id.*
198. *Id.*
199. Helge, *supra* note 58, at 52.
200. *See* Mayer & Wilson, *supra* note 25, at 529 (suggesting that "contract [companies] would try to maximize current profits by going easy on their charity clients, especially if by doing so they could increase their revenues either by attracting more clients or providing other fee-based services").
201. Helge, *supra* note 58, at 51.
202. *Id.* at 69.
203. *Id.*
204. Mayer & Wilson, *supra* note 25, at 503. NASD is now called the Financial Industry Regulatory Authority. *Id.*
205. Marcus S. Owens, *Charity Oversight: An Alternative Approach* 11–12 (Hauser Ctr. for Nonprofit Orgs., Harvard Univ., Working Paper No. 33.4, 2006).
206. Helge, *supra* note 58, at 71.

There are several theories as to how the charitable sector should be overseen, but there is one general consensus—it must be reformed. Although no solution may be perfect, some reformation is better than the current model.

IV. PROPOSAL FOR A STATE SELF-REGULATORY NONPROFIT ORGANIZATION

Though scholars have proposed a variety of solutions to the problem of charitable oversight, all of the solutions have flaws. This Comment proposes a self-funded state regulatory organization, called the Louisiana Charitable Regulatory Organization ("LCRO"), responsible for regulating charitable organizations. The LCRO's self-funded model would place minimal reliance on the state government and avoid funding deficits, government interference, politicization, and a lack of accountability within the sector.

A. The LCRO's Structure, Responsibilities, and Model for Enforcement

A proper structure to the LCRO is critical to its functioning. A state legislative committee would charter the LCRO and appoint members to its executive body.[207] Members of this executive board could potentially include donors and beneficiaries of the charitable sector, former staff of the attorney general's office, and current or former directors from charities.[208] This executive governing body would be responsible for conducting investigations, handing out penalties against violating organizations, and reporting to the state committee. LCRO employees would handle investigative procedures and bring charges against violating organizations to the LCRO board.

The LCRO would regulate all charitable formation and organization. Any organization seeking to form as a charity, and specifically as a charitable organization, within the state would first apply to the LCRO for approval before commencing operations in the state. The LCRO would have exclusive control to grant approval to applicants and also control organizations' tax-exempt status within the state.[209]

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207. *See id.* at 70 (describing how a similar federal oversight body would be structured and operate).

208. *Id.* at 71.

209. Existing organizations could be grandfathered in and would not have to seek approval to form once the LCRO began operating. This process would most likely include short forms for the charities to fill out and file with LCRO. Currently, charitable organizations receiving tax-exempt status from the IRS automatically receive tax-exempt status in Louisiana by submitting a copy of the ruling of exemption from the IRS. *Corporation Income & Franchise Taxes*, LA. DEP'T REVENUE, http://revenue.louisiana.gov/CorporationIncomeAndFranchiseTaxes#IncomeTax

Primarily, the LCRO would be responsible for oversight of charities operating in Louisiana. The LCRO would promote and distribute uniform rules and regulations that charities must follow, apprising charitable organizations of exactly what standards they must follow. [210] The greatest benefit of the LCRO is the unified system of oversight and standardized accountability in a central enforcement body.

To ensure transparency and garner the public's trust in this new model, the LCRO would make the results of investigations publicly available.[211] In addition, an independent auditor would review the LCRO's operations and finances and provide a copy of this report to the state committee and the public.[212] An additional check on the LCRO's operations could include a charity's ability to appeal decisions through the regular judicial process.[213]

B. The Necessity of a Self-Funded Model

A self-funded model would allow the LCRO the flexibility needed to adapt and meet the needs of the charities it governs.[214] To achieve self-sustaining status, the LCRO would charge a mandatory annual fee to all charitable organizations operating in the state, rather than only the ones using charitable solicitors.[215] To avoid drastic burdens and overcharges on smaller organizations, the LCRO would enforce the mandatory fee on a sliding scale, dependent on the charity's annual donations.[216] These proceeds would be used to run the LCRO's day-to-day operations of charitable oversight. Other fee assessments could include an application fee, fines, and settlement awards against charities that violate LCRO regulations.

[http://perma.cc/45K6-GTU9] (last visited Sept. 2, 2015). LCRO would usurp this power from the Louisiana Department of Revenue, and develop its own criteria for determining state tax-exempt status within Louisiana.

210. For an example of what this might look like, see EDMUND G. BROWN JR., CALIFORNIA ATTORNEY GENERAL'S GUIDE FOR CHARITIES (2005) *available at* http://oag.ca.gov/sites/all/files/agweb/pdfs/charities/publications/guide_for_charities.pdf [http://perma.cc/6DCD-8K5N].

211. Helge, *supra* note 58, at 75.

212. *Id.* at 71.

213. *Id.* at 75. A charity's decision to remove an individual director would also be appealable directly by the individual.

214. To get started, the LCRO may require government funding to begin operations; however, the goal would be to wean off government involvement over a set period of years.

215. *See supra* Part II.G.

216. *See supra* note 131.

C. The Benefits of a New System of Oversight

Although some problems, including the lack of funding for enforcement, could be solved without removing authority from the attorney general, a new state regulatory organization would more squarely address all of the constraints that currently hinder the office.[217] A primary benefit of the LCRO is having an oversight body focused solely on the regulation of the charitable sector. Also, the LCRO would overcome the financial constraints that currently impede effective charitable oversight from the attorney general's office. Annual fees from charities would help ensure that the LCRO has the flexibility needed to adjust and correct the enforcement needs of the charitable sector.[218]

The LCRO would also avoid political and governmental constraints that hinder present enforcement. A current system that the LCRO could aim to mimic is FINRA.[219] The LCRO could additionally remove political influences by including broad representation on the executive board, thus protecting against governmental and political influence.[220] Transparency, independent audits, and oversight from the state committee would ensure that the executive board is using effective enforcement measures free from political agendas.[221] Although the possibility of making changes to the current oversight system exists, restructuring and restarting with the LCRO would allow an oversight model to be fashioned in a way to address the issues with the current system.

D. LCRO Problems to Consider

A significant obstacle to creating a new state-level regulatory organization is a lack of political will.[222] Very few state legislatures have

217. Helge, *supra* note 58, at 79.
218. *Id.*
219. *See supra* Part II.C. Other private organizations that regulate professionals, such as the American Bar Association and the American Medical Association, could also be used as examples in developing LCRO. *See generally ABA Mission and Goals*, AM. BAR ASS'N, http://www.americanbar.org/about_the_aba/aba-mission-goals.html (last visited Sept. 21, 2015); *AMA Mission & Guiding Principles*, AM. MED. ASS'N, http://www.ama-assn.org/ama/pub/about-ama.page? (last visited Sept. 21, 2015).
220. Helge, *supra* note 58, at 80.
221. *See generally* Mayer & Wilson, *supra* note 25, at 537 (addressing concerns of political capture in a new enforcement model).
222. *Id.* at 545. Political will is "the demonstrated credible intent of political actors to take meaningful action towards reform." Fran Quigley, *Growing Political Will from the Grassroots: How Social Movement Principles Can Reverse the Dismal Legacy of Rule of Law Interventions*, 41 COLUM. HUM. RTS. L. REV. 13, 16 n.8 (2009).

passed legislation requiring depth in charitable oversight, and "whether any state legislature[] [has] provided the state attorney general's office with adequate funding or staffing to effectively regulate charities" is dubious.[223] Louisiana's legislature would have to take a more proactive approach in charitable oversight and realize the problems current oversight measures present. But scholarly criticism and the influence from states that have developed better enforcement procedures have begun to push charitable reform to a national level, which may help overcome this obstacle.[224]

Another potential concern is coordination between a new regulatory organization and other state and federal oversight agencies.[225] The LCRO will also have to coordinate with the IRS.[226] A strong developmental and planning phase prior to implementation will ease the transition to LCRO oversight. This type of planning stage will help ensure that all organizations are on the same page when the LCRO begins to operate. There is no one correct way to offset the coordination concern; it will be important to take note of the issue in the transition phase.

A bigger concern is the coordination between the LCRO and regulatory programs of other states. This problem is probably not entirely solvable but can be mitigated through various measures. First, the LCRO would need to have absolute clarity in its regulations to ensure that charities operating in multiple states know exactly what is expected of them in Louisiana.[227] Secondly, the LCRO's model would not be entirely different from the current regulatory system in place, allowing charities to easily operate in Louisiana and other states. Although the state-to-state enforcement problem is a concern, it can be mitigated with a detailed transition and planning phase that directly communicates to charities operating in Louisiana what to expect before the LCRO officially begins operations.

The state legislative committee tasked with chartering the LCRO could appoint members or former members of the attorney general's office to the LCRO's executive board to smooth the transition of oversight to the organization. The attorney general's office may be hesitant to give up its power to regulate charitable organizations, so this type of appointment could help ease the transition. Although the public could see switching to

223. Mayer & Wilson, *supra* note 25, at 545.
224. Another problem with implementing LCRO could be the challenges faced when a new agency or commission is created. These issues, however, are beyond the scope of this Comment.
225. Mayer & Wilson, *supra* note 25, at 541.
226. *Id.* at 542.
227. The LCRO could also issue private letter rulings, like the IRS, to charities questioning their compliance with the new regulations.

a new system as a waste of resources,[228] the positive effects that the LCRO would have on charitable oversight would outweigh the problems created by Louisiana's transition to the organization.

CONCLUSION

A new enforcement model is necessary to properly monitor charitable organizations in Louisiana. Current restrictions on oversight through the attorney general's office and a lack of proper enforcement measures have made efficient regulation of the charitable sector practically nonexistent. The charitable sector must maintain the public's confidence, making reform necessary. Although no solution may be the perfect solution, the current oversight problems provide an opportunity for Louisiana to adopt a new enforcement model. A self-funded state regulatory organization, such as the LCRO, will address the financial, political, and organizational constraints that hinder oversight through the attorney general's office. The new system will allow Louisiana to set a precedent for charity reform across the country and finally address a problem scholars have criticized for over 50 years.

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228. *See id.* at 520 (suggesting that taking advantage of existing attorney general expertise in a new model would cut back on waste in the transition to a new enforcement organization).

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