

**MEMORANDUM IN SUPPORT OF A MOTION TO AMEND
SECTIONS 660, 670 AND 680 OF TENTATIVE DRAFT NO. 3
OF PRINCIPLES OF THE LAW OF NONPROFIT ORGANIZATIONS**

The undersigned member of the American Law Institute is proposing to move at the 2011 Annual Meeting that Sections 660, 670 and 680 of Tentative Draft No. 3 of Principles of the Law of Nonprofit Organizations be amended in the manner hereinafter described for the following reasons:

1. As presently drafted, Section 680(a) denies an attorney general the ability to grant standing to a plaintiff unless the attorney general has a conflict of interest, but permits a plaintiff to attack a settlement approved by the attorney general. Section 680(a) thus, on the one hand, creates an unnecessary obstacle to securing relief for misconduct by fiduciaries in cases where there is no attorney general or similar governmental official who supervises charities or where there is such an official and he or she approves the proposed litigation by a private party or is simply too busy or underfunded to become involved in the matter, and, on the other hand, intrudes on the judgment of the attorney general in settling disputes. As Section 680(a) is proposed to be amended, where a state places limitations on standing of private parties to commence litigation against nonprofit organizations and provides a specific procedure for seeking the attorney general's approval to bring an action, such procedure would need to be followed in order to obtain standing, and the revised comment to Section 680(a) should so state. (see, e.g., California Corporations Code section 5233(c)(4)). When the attorney general or other similar official negotiates a settlement of a matter or declines to permit a plaintiff to pursue the matter, the plaintiff would have no standing under Section 680(a), as proposed to be revised, and the comment to revised Section 680(a) should so state.

2. By requiring that a plaintiff have a "special relationship" to the matter at issue and to the charity in order to have standing to seek judicial review of fiduciary misconduct, Tentative Draft No. 3 unnecessarily constrains the ability to seek judicial review of misconduct of fiduciaries who engage in self-dealing or other breaches of the duty of loyalty. Comment a to Section 680 candidly admits that "The grant of standing based on a special interest will be rare." Furthermore, the meaning of a "special relationship" is unclear, particularly in the context of standing to bring a derivative action, and could lead to unnecessary litigation.

3. By requiring that complained of behavior be "egregious" or the circumstances "exigent", Section 680 limits the ability to obtain judicial review of self-dealing transactions or other breaches of the duty of loyalty to cases where the misconduct is material and the misbehaving fiduciary dominates the governing board. See Comment b(2) to Section 680 (a remedy for theft or self-dealing is limited to cases where the amount is material and the allegedly misbehaving fiduciary dominated the governing board and continues to do so). Under this comment, the action of a trustee of an art museum who does not dominate the board but who acquires a painting of a lesser artist from the museum

at a price below market value without disclosure to and approval by the board would not be subject to judicial review unless the other trustees chose to pursue legal action.

4. Adopting the changes to Sections 660, 670 and 680 proposed by the undersigned will not open a charity to costly litigation because Subsections 650(c) and (e) adequately protect the charity from abusive litigation.

For the foregoing reasons, the undersigned moves that the following changes be made in Sections 660, 670 and 680 of Tentative Draft No. 3:

1. Section 660(a)(3) be amended to read: "(3) A person satisfying the requirements of Section 680(c),"

2. Sections 670(b)(3) and 670(c)(3) be amended to read: "(3) A person satisfying the requirements of Section 680(b)."

3. Section 680 be amended to read as set forth in Exhibit A attached hereto. As so amended, Section 680(c) would limit the ability to bring derivative actions by someone other than a member of the governing board or other person having significant governance authority to cases involving conflicts of interest involving a member of the governing board, and would not permit suits alleging breach of the duty of care, except where the governing board had approved action that could adversely affect the tax-exempt status of the charity, which is a basis for granting standing currently recognized by Comment b(2) to Section 680.

Dated: May 2, 2011

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A member of the American Law Institute and co-Reporter for the Institute's Principles of Corporate Governance

EXHIBIT A

§ 680. Standing of Certain Persons: Gift Enforcement and Derivative Suits

(a) In determining whether the plaintiff qualifies as a person subject to this section for purposes of either Subsection (b) or Subsection (c), the plaintiff must show that there is no attorney general or other authorized government official available or willing to seek judicial review of the complained-of behavior, or that such official has approved of such action by the plaintiff.

(b) A plaintiff who can make the showing required by Subsection (a) is a person contemplated in § 670(b)(3) or (c)(3), with standing to initiate or participate in a suit to enforce or modify the purpose of a charitable trust or a restricted gift made to a charity only if the plaintiff demonstrates that:

- (1) The charity has applied, is applying, or intends to apply a material portion of a major charitable trust or restricted gift to another purpose; and
- (2) The plaintiff fairly and adequately represents the interests of the intended beneficiaries of the trust or gift.

(c) A plaintiff who can make the showing required by Subsection (a) is a person contemplated in § 660(a)(3), with standing to bring a derivative suit under § 650, only if the plaintiff demonstrates that:

- (1) The behavior complained of concerns a conflict of interest involving a member of the governing board of the charity (see §§ 310, 330), or an action approved by the governing board that could adversely affect the tax-exempt status of the charity; and
- (2) The remedy sought is particularized to address the injury to the charity.