The Charitable Trust Doctrine: Application to Unrestricted Gifts

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At common law, assets held by charitable nonprofit organizations are generally understood to be held by such organizations in trust for public benefit. *See* A. Curreri, *Charitable Trusts Definitions and History--Purpose--Beneficiaries--Cy Pres Doctrine*, 9 St. John's L. Rev. 114 (Dec. 1934). This principle, called the "Charitable Trust Doctrine," is mirrored in the Internal Revenue Code's prohibition on organizations recognized as public charities for tax purposes from using more than an insubstantial portion of their assets for private benefit. I.R.C. § 1.501(c)(3)-1(c)(i). Although this principle is broadly recognized throughout the United States (*see* Harold L. Kaplan, Patrick S. Coffey & Rosemary G. Feit, *The Charitable Trust Doctrine: Lessons and Aftermath of Banner Health*, 23 Am. Bankr. Inst. J., no. 4, May 2004, at 28), the extent of its reach in shielding assets from the claims of creditors is unclear.

Two areas associated with the application of the Charitable Trust Doctrine in particular remain unclear: *First*, does the Charitable Trust Doctrine shield only assets that are restricted (expressly by the donor or by implication) to a narrow or specific charitable purpose of a charitable nonprofit corporation or does it shield unrestricted assets as well; and *second*, if such shield is narrowly applied to only "restricted" assets, how is such shield to be applied to an asset that derives from both restricted gifts and unrestricted gifts?

In this article, we outline the Charitable Trust Doctrine generally and provide examples of how it raises concerns in certain real-world settings. We then survey case law attempting to apply the Charitable Trust Doctrine in both bankruptcy and nonbankruptcy settings. Finally, we survey case law attempting to apply the Charitable Trust Doctrine to assets that derive from both restricted and unrestricted sources and suggest some (tentative) conclusions and suggestions for practitioners.

Background

Although accounting treatment of assets of a charitable nonprofit may not fully mirror state law treatment, most nonprofit executives and board members and most lawyers representing nonprofit borrowers or lenders lending to nonprofits will recognize the formulation applied by the American Institute of Certified Public Accountants (AICPA) to distinguish what were traditionally called "permanently restricted" assets from "unrestricted" or "temporarily restricted" assets. In its Standard ASU 2016-14, the AICPA reformulated those terms to "assets with donor restrictions" and "assets without donor restrictions," but whatever the nomenclature, the accounting standards distinguish these two classes of assets, as does state law in many cases in the application of the Charitable Trust Doctrine. Although the distinction (between what we will call "restricted" and "unrestricted" assets) is recognized in the accounting standards and in many cases at common law, in practice, particularly in settings where assets were acquired many years ago, applying it can be quite difficult. This difficulty is particularly pronounced in the case of tangible assets because assets acquired with money that was originally either restricted or unrestricted retain (in theory) the character of the money used to acquire such assets (at least for accounting purposes), although in many cases, an asset is acquired with a mix of restricted and unrestricted cash and investments.

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The insulation of restricted gifts and assets derived from restricted gifts from the claims of creditors of a charitable nonprofit is broadly recognized in bankruptcy case law. *See, e.g.*, *In re Cath. Diocese at Wilmington, Inc.*, 432 B.R. 135 (Bankr. D. Del. 2010). Outside of bankruptcy, this protection is also frequently recognized (*see, e.g.*, *In re Friends for Long Island's Heritage*, 80 A.D.3d 223 (N.Y. App. Div. 2010)), but, as discussed in Parts II and III, whether this protection extends to unrestricted assets of a charity remains at best unclear and case law in most jurisdictions addressing the Charitable Trust Doctrine is scant. Moreover, there is even less clarity about whether claims of creditors extend to tangible assets originally acquired with a mix of restricted and unrestricted monies, and countervailing public policy considerations cloud the picture further.

Example

To help illustrate this dilemma, imagine a charitable nonprofit corporation that has owned and operated a home for the aged (the Home) for over 70 years. The Home was originally built by the nonprofit charity with money it raised through a fund-raising campaign that sought gifts specifically for building the Home (i.e., restricted gifts), although when that campaign fell short of the charity's goal, it engaged in a more broad solicitation that included appeals for money to operate the Home as well as separate appeals that made no mention of the Home (i.e., unrestricted gifts).

Although in most cases the records would not be clear 70 years later, imagine that the charity has records that suggest that one-half of its fund-raising success was from gifts that specifically mentioned the Home and one-half was from solicitation that did not mention the Home. (And for simplicity sake, assume the charity did not borrow money for the building or renovation of the Home, and because no rent or investment income was derived before the Home was placed in service, we can ignore these potential sources of money for this illustration as well.) Now consider that a resident of the Home suffers an uninsured or underinsured slip-and-fall in the Home and obtains a judgment against the charity. Similarly, consider the situation where the charitable nonprofit seeks to obtain a mortgage loan to renovate the Home. The question that must be answered in both these fact patterns is whether a judgment (whether arising from the slip-and-fall situation or a default under the mortgage loan) can be realized against the Home itself as well as against the unrestricted cash and investments the charity uses to operate the Home or holds in reserves. For the purposes of this example, let's assume that the charity is *not* considering a voluntary bankruptcy, but would be rendered insolvent if the judgment were realized against the Home.

Analysis

In examining this fact pattern, again we start with the proposition that restricted assets (including assets obtained with unrestricted gifts) of a charity are outside of the reach of creditors. Although this position is not universally recognized (see Restatement (Second) of Trusts § 402(1) cmt. & § 403), the courts in the cases reviewed in this article all presume that, under applicable state law, this liability shield applies. In fact, there is little case law elaborating on the Charitable Trust Doctrine outside of bankruptcy or dissolution settings, but such case law as there is reflects an acknowledgment, expressly or implicitly, of this doctrine. As the court in *Salisbury v. Ameritrust (In re Bishop College)*, 151 B.R. 394 (Bankr. N.D. Tex. 1993), said: "*(i)t is a basic tenet of the law of charitable trusts that beneficial charitable [assets] are inalienable.*"

Under the Charitable Trust Doctrine, a charity is understood to be acting as the trustee for an imputed charitable trust as to those assets held by it that are subject to the Charitable Trust Doctrine and, consequently, the charity does not have the discretion to use those assets to pay the claims of creditors except in a manner consistent with the terms of the imputed trust. Restatement (Second) of Trusts § 348 defines a charitable trust as "a fiduciary relationship with respect to property arising as a result of a manifestation of an intention to create it and subjecting the person by whom the property is held

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to equitable duties to deal with the property for a charitable purpose." Under § 348(f), restricted gifts to nonprofit charitable corporations are deemed to create a charitable trust, although case law and the Restatement are inconsistent concerning the extent to which this doctrine protects otherwise apparently unrestricted gifts or assets. Evelyn Brody, *The Charity in Bankruptcy and Ghosts of Donors Past, Present, and Future*, 29 Seton Hall Legis. J. 471, 504 (2005). Section 348 of the Restatement formulates the duty of a charitable corporation as to unrestricted gifts as a duty "not to divert the property to other purposes but to apply it to one or more purposes of which [the nonprofit] is organized"; this ambiguous statement would seem to suggest that unrestricted gifts or assets are shielded in a manner similar to that given the restricted gifts or assets, although the fact that the Restatement treats unrestricted and restricted assets in different sections and with different language may suggest otherwise. As we shall see, the case law in this area is no less confused.

Often courts have found that an otherwise apparently unrestricted gift or asset is protected from claims of creditors when the donor's gift instrument states a general charitable intent. In some cases, courts have presumed a restriction onto gifts that are not expressly restricted by the donor when (1) there was no express limitation to the contrary made by the donor and (2) paying creditors using unrestricted funds would have rendered the charity insolvent. This mental gymnastics suggests a view that only restricted gifts or assets are insulated by the Charitable Trust Doctrine.

In other cases, courts have found that an otherwise apparently unrestricted gift or asset is not protected from claims of creditors when the donor can be reasonably said to have expected, at the time of naming the charity in the gift instrument, that paying relevant debts of such charity while it was still discharging its charitable purpose was in furtherance of the charitable purpose of such beneficiary. Again, these cases suggest a view that only restricted gifts or assets are shielded from creditors' claims under the Charitable Trust Doctrine.

Under section 541 of the Bankruptcy Code, property of the debtor's estate is limited to all "legal and equitable interests" of the debtor in property at the commencement of the bankruptcy proceedings. 11 U.S.C. § 541. The Code excludes from the estate of the debtor any property with "a restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable non-bankruptcy law." *Id*. Since the extent of a debtor's interest in property is determined by state law, this section of the Bankruptcy Code is understood to recognize the common law Charitable Trust Doctrine in the protection of certain charitable gifts or assets by shielding certain gift of assets of a charitable trust from creditors in a bankruptcy proceeding. *Butner v. United States*, 440 U.S. 48 (1979). *See also Owen v. Bd. of Dir. of the Wash. City Orphan Asylum*, 888 A.2d 255, 260 (D.C. 2005) (discussing in dicta the applicability of the Charitable Trust Doctrine to nonprofit corporations).

In applying section 541 and the Charitable Trust Doctrine both in bankruptcy and outside bankruptcy, courts have often interpreted the Charitable Trust Doctrine to impute restriction to otherwise apparently unrestricted donations in certain situations and thereby suggest a view that only restricted gifts or assets are protected. The essence of the reasoning in these cases is an effort by the courts to honor the donor's intent. Generally, notwithstanding exceptions discussed in the scant case law available, the courts presume that a donor giving for a general charitable purpose intends that the gift or asset be used for objects for which the charitable corporation was formed. The methodology to identify these objects is far from clear. On the one hand, some courts have ruled that satisfying the creditors of a defunct charity cannot be a charitable purpose for which a donor had intended its gift. On the other hand, some courts have determined that creditors are integral to the fulfillment of the charitable mission and a donor fully expects that its gifts will be used to pay related debts. None of these decisions, except for the *Blocker* court of Texas, cites state statutory law. *Blocker v. State of Texas*, 718 S.W.2d 409 (Tex. App. 1986),

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writ refused NRE (Jan. 21, 1987). Instead, they rely on cross-jurisdictional common law judicial rulings, the Restatement (Second) of Trusts, and public policy considerations. More often than not, the courts explicitly state that there is neither state law nor prior case law within their jurisdiction on point.

In almost all of the cases discussed here, except in *Revis v. Ohio Chamber Ballet*, 2010-Ohio-2201 (Ohio 2010), the gifts in dispute were bequests to a charity. Although some of the decisions in this area turn on whether a bequest has vested in the charity and thus whether the assets in question belong to the charitable corporation's estate, the decisions are not consistent on whether the charitable corporation may or must use the bequeathed property that is not expressly limited to a particular, narrow use to pay its creditors. In cases where the courts find that the charitable corporation may not use such gifts or assets to pay its creditors, the *cy pres* doctrine is often applied. In these cases, the gifts or assets were diverted to another charitable corporation that is able to advance the charitable purpose for which the property was originally given. To apply *cy pres*, the courts either specifically recognize a restriction or either impute a restriction or implicitly assume an unrestricted gift or asset is nonetheless subject to the Charitable Trust Doctrine and, thus, feel bound to discharge the express or imputed trust through diversion to another charity. In all of these cases, it appears that the court assumes that the Charitable Trust Doctrine would shield restricted gifts or assets from claims of creditors, but the law remains unclear as to whether the Charitable Trust Doctrine also shields unrestricted gifts or assets.

All the cases discussed in the second half of this article involve charitable corporations that either filed for liquidation (under Chapter 7) or reorganization (under Chapter 11), or voluntarily dissolved through other arrangements. For dissolution cases, see *Blocker v. State of Texas*, 718 S.W.2d 409 (Tex. App. 1986), *writ refused NRE* (Jan. 21, 1987); *Montclair Nat'l Bank & Tr. Co. v. Seton Hall Coll. of Med. & Dentistry*, 96 N.J. Super. 428, 437–38 (App. Div. 1967), and *Revis*, 2010-Ohio-2201.

Earlier in this article, we presented an overview of the Charitable Trust Doctrine and presented two fact patterns for readers to consider (a slip-and-fall judgment creditor fact pattern and a mortgage lender judgment creditor situation). Next, we examine case law seeking to apply the Charitable Trust Doctrine. Later, we will examine case law applying the Charitable Trust Doctrine to assets that derive from mixed sources (restricted and unrestricted gifts) and offer some conclusions and thoughts for practitioners.

Cases Insulating Otherwise Apparently Unrestricted Gifts

In re Bishop College, 151 B.R. 394 (1993), is a case in point. There, Bishop College, the debtor, which was the beneficiary of two testamentary trusts, ceased to function as an educational institution. It filed a voluntary petition under Chapter 7 for liquidation several years after being named as a beneficiary of the two subject trusts. The trustee of the testamentary trusts refused to make further distributions to the college on the grounds that the charitable intent of the donors could no longer be fulfilled because the college had ceased to function. The Chapter 7 trustee demanded that the corpus and income of the two trusts be turned over to the college's estate for payment of creditors in accordance with the Bankruptcy Code's priority scheme.

The court found that, under Texas law, an unrestricted gift to an educational institution may be presumed to be a charitable gift for educational purposes. In effect, the court presumed a restriction on what otherwise might appear to have been an unrestricted gift. The court rejected the argument that the unrestricted nature of the charitable gift to Bishop College demonstrated a lack of charitable intent. Therefore, it rejected the Chapter 7 trustee's argument that the donor's general intent can be met by using the unrestricted gifts to pay the college's creditors. Instead, the court treated the assets of the trusts as outside of the reach of the college's creditors, and its reasoning suggests its view that the Charitable Trust Doctrine would not apply to unrestricted gifts or assets.

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The *In re Bishop College* court relied on the Restatement (Second) of Trusts and case law from the bankruptcy courts in Texas and other states, including Nebraska, Ohio, and Pennsylvania. Additionally, the court substantially relied on public policy considerations that it said were state-specific. It explained:

> State law relating to charitable trusts militates against the termination of the Bishop College Foundations for the payment of [. . .] creditors. Texas courts hold charitable trusts in such high regard that the rules of construction are more liberal to sustain them, than they would be if the gifts were to private trusts or individuals.

151 B.R. at 400.

Blocker v. State of Texas, 718 S.W.2d 409 (Tex. App. – Houston 1986), is another case on point. There, a property was transferred unconditionally to the Houston Conservatory of Music (HCM), a nonprofit charitable corporation. The purpose of HCM, as stated in its articles of incorporation, was to "be a non-profit operating strictly for the purpose of teaching the Youth of this land music and its allied arts." *Id.* at 411. Decades later, HCM's board of directors decided to dissolve HCM, pay the liabilities of the corporation, and distribute any remaining assets back to the estate of the original donor.

The court of appeals declared the deed, which conveyed the property of HCM to the estate of the original donor, void *ab initio*. It awarded title and possession of the property to a newly-formed charitable organization impressed with a public charitable trust under the *cy pres* doctrine.

In its reasoning, the court explained that the actions of the dissolving nonprofit were governed by the Texas Non-Profit Corporation Act (Act). It acknowledged, however, that Texas courts had not yet directly addressed the issue of whether a property transferred unconditionally to a nonprofit corporation is subject to implicit charitable limitations. In answering the issue, the Texas court relied on reasoning provided by courts in other states, including California and Nebraska. First, the court emphasized that the identity of HCM was permanently and irrevocably established as charitable in its articles of incorporation. Second, the court applied the Act to the facts of the case. The decision turned on the question of whether the asset application and distribution plan adopted by HCM's directors was subject to the provisions of section 1396-6.02A(3) of the Act, which read:

> Assets received and held by the corporation subject to limitations permitting their use only for charitable, religious, eleemosynary, benevolent, educational or similar purposes, but not held upon a condition requiring return, transfer or conveyance by reason of the dissolution, together with any income earned thereon shall be transferred or conveyed to one or more domestic or foreign corporations, societies or organizations engaged in activities substantially similar to those of the dissolving corporation, pursuant to a plan of distribution adopted as provided in this Act.

Blocker, 718 S.W.2d at 412. The court, relying on case law from other states and the Act, concluded that a property transferred unconditionally to a public charity was subject to implicit limitations defined by the charity's organizational purpose. The restriction was presumed by the court partially because the gift transfer instrument did not state an express limitation to the contrary. The court underscored that "[n]o technical words or further manifestations of general charitable intent [were] necessary in order to create such a trust." *Id.* at 415. Thus, acceptance of such donated assets established an imputed charitable trust as if the assets were subject to an express limitation mandating that they were to be held solely for the declared charitable purposes. Therefore, the *cy pres* doctrine applied and the subject assets were not available for use other than by another similar charity. Although this decision did not address claims of creditors, it does suggest an expansive application of the implied restriction approach and recognized that restricted assets are outside of the reach of creditors. Again, the reasoning of the court suggests that only restricted assets of a charity are outside the reach of creditors.

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In re Estate of Kraetzer, 119 Misc. 2d 436, 437–41 (N.Y. Sur. Ct. 1983), 462 N.Y.S.2d 1009, is another case on point. There, a hospital that was named as one of the residual beneficiaries in a will ceased its operations and engaged in a Chapter 11 reorganization bankruptcy proceeding before receipt of the subject bequest. The testator specified that the gift to the hospital was "to its sole use, benefit and behoof, absolutely and forever." *Id.* at 437. The hospital sought to retain the subject funds as part of its plan of reorganization. The court held that "whatever its inherent merits, the courts have uniformly held that the intention of a testator in making a general gift to a charitable corporation was the furtherance of the charitable purpose for which the entity was formed as set forth in its charter." *Id.* at 439. In the case of hospitals, such purpose is "the actual and continued provision of acute patient care services rather than the satisfaction of creditors' claims." *Id.* Accordingly, the court, having imputed a restriction to the gift, declined to permit the subject assets to be used to pay the claims of creditors. The court explained that the wording of the donor's gift did not compel a different conclusion. The wording constituted "a mere draftsman's mannerism rather than a broad grant of authority to [the hospital] to use the fund for a purpose other than the continued operation of its facilities for the care of ill and injured persons." *Id.* at 440. Hence, the court decided that the gift intended for the hospital should be applied under *cy pres* to a similar charitable use because of the cessation of the intended charitable operations by the original beneficiary, but again here with the result that the claims of creditors were not satisfied with what otherwise may have appeared to be unrestricted assets of the charity. And again, the reasoning of the court suggests that only restricted assets are shielded in this manner.

To the same effect, see also *In re Forum Health*, 444 B.R. 848, 863 (Bankr. N.D. Ohio 2011), denying unsecured creditors' objections to a nonprofit board member's failing to use unrestricted funds to pay unsecured creditors.

Cases Permitting Otherwise Apparently Unrestricted Gifts to Be Used to Pay Debts

In some cases, the court concludes, based on policy and not necessarily any specific facts, that a donor fully expects that its general (unrestricted) donation will be used to pay debts and expenses a charity incurs in discharging its mission. Because discharging its mission in furtherance of its charitable purpose involves incurring debt, the relevant debts and expenses are said by these courts to be in furtherance of the charity's charitable purpose. Thus, absent any express indication by the donor to the contrary, the donor's general intent may be found, by implication, to include paying debts incurred while the charitable corporation was actively pursuing the charitable purpose for which it was created. Here, too, by looking to the intent of the donor, the courts seem to suggest that only restricted assets are shielded, even if, in practice, their reasoning requires that restrictions are read in such a way as to make the subject asset available to creditors

In *In re Boston Regional Medical Center, Inc.*, 298 B.R. 1, 28–29 (Bankr. D. Mass. 2003), is a case on point. There, the bankruptcy court considered whether payment of a charity's creditors using unrestricted funds fell within the charitable purpose of the organization. The court addressed this question in the context of a debtor charity that had permanently discontinued its operations and entered liquidation proceedings. In that setting, the court found that the charity remained qualified to receive a bequest intended for charitable purposes where the bequest would be used to pay debts incurred prior to the liquidation and in furtherance of the corporation's charitable mission.

Boston Regional Medical Center, Inc. (BRMC) was a debtor and a beneficiary to a one-third interest in the residue of three testamentary trusts. Almost a year after being named as a beneficiary, BRMC filed a petition under Chapter 11 of the Bankruptcy Code and discontinued hospital operations within a few days thereafter. BRMC sought an order directing the trustees of the testamentary trusts to turn over to it the funds representing BRMC's one-third interest in each trust. The two other residuary beneficiaries of

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the testamentary trusts opposed the request. They argued that BRMC, by virtue of its financial difficulties and ultimate discontinuance of hospital operations, had, before the date of distribution, become unable to use the funds for a charitable purpose. One of the beneficiaries asked that the testamentary provisions of the trusts be reformed to require that the bequest to BRMC be used "to provide a bed for indigent patients" as was required by the will that established the three testamentary trusts. They further sought a court decision that BRMC may not receive the bequest as so modified because it could no longer provide a bed for indigent patients.

The court relied on public policy considerations and case law from other jurisdictions in determining that paying the hospital's creditors fell within BRMC's charitable purpose and hence that the subject gift was available to pay claims of creditors. The court explained that "payment of creditors is essential and integral to the carrying on of the charitable mission of the hospital [because] it is the creditors who carry out the charitable work." *Id.* at 28. If it were not for the employees, suppliers, lenders, and others supporting and facilitating the delivery of the healthcare services, the court asserted, a hospital, even a not-for-profit one, simply would not exist. Therefore, a donor who gives money to a hospital understands fully well that the donee will not apply the donated funds directly "to the patients' wounds." *Id.* Rather, the hospital will use the money to pay the employees and other creditors through whom it provides medical care to its patients. The court highlighted that if payment of creditors were inconsistent with the charitable mission of a charitable corporation, then such corporations would have to pay for goods and services in advance, and they could never use debt financing. In a credit economy, such a situation would restrict charities in the performance of their charitable functions.

The timing of the incurrence of debt was irrelevant to the determination of the court. The court underscored that the debt in question was incurred for BRMC's operation and, hence, they served the charitable mission. The court clarified that *In re Bishop College* (discussed above) and *Estate of Kraetzer* (discussed above) failed to explain (1) how a charitable organization can perform its charitable purpose without paying its employees, lenders, suppliers, etc.; (2) how a charitable hospital might use its donations if not to pay its employees, lenders, suppliers, etc.; and (3) why payment in arrears is materially different (for purposes of determining charitable purpose) from advance or contemporaneous payment. The *Boston Regional* court explained that in both of those prior cases, the courts simply assumed without a proper consideration that payment of a charity's creditors is inconsistent with and beyond its charitable purpose. Thus, the *Boston Regional* court ruled that the charitable purpose is furthered by payment of debts and expenses incurred in advancing an organization's charitable purpose because, it felt, a donor fully expects that this is the purpose to which a donation will be put. Critically, however, the subject gift in this case was not a restricted gift. Thus, this case can be reconciled with the prior cited cases insofar as all appear to recognize, expressly or implicitly, that although restricted assets are insulated from creditors' claims under the Charitable Trust Doctrine, unrestricted assets are not.

Another similar case is *Montclair National Bank & Trust Co. v. Seton Hall College of Medicine & Dentistry*, 96 N.J. Super. 428, 437–38 (App. Div. 1967). There, the Superior Court of New Jersey, Appellate Division, considered the question of whether Seton Medical was entitled to its residuary share of the estate given with no restrictions by a testator.

Seton Medical, as one beneficiary of a testator's estate, ceased operation through voluntary dissolution two years after being named a beneficiary and before gift distribution. The trial court found that the intention of the testator would be most nearly approximated if another medical college became the *cy pres* successor beneficiary of the residuary portion in question. The appellate court disagreed. The gift was generally intended to promote medical education. Nowhere was it alleged that Seton Medical's debts were not contracted as the result of services and expenses related to that end. Thus, the court found

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that the application of the funds towards the diminution of Seton Medical's debts would have the effect of furthering the testator's intended charitable and testamentary purpose, i.e., the payment of expenses incurred in teaching medicine and dentistry. The court emphasized that the medical school's debts, which were contracted while the school was actively engaged in teaching medicine, were a proper purpose for which funds could be used. This conclusion stood even though at the time of the creditors' payment the school was no longer engaged in teaching medicine. Here, too, we see unrestricted gifts falling outside of the liability shield of the Charitable Trust Doctrine.

Revis v. Ohio Chamber Ballet, 2010 Ohio 2201 (Ohio Ct. App. 2010), 929 N.E.2d 1068, further advances the discussion started in *Boston Regional* and *Montclair National Bank and Trust*. There, the Ohio Chamber Ballet (OCB), which had ceased its activities through dissolution, sought disbursement of donated funds to pay off its debts. The court distinguished the facts and, thus, the courts' decisions in *Boston Regional* and *Montclair National Bank and Trust* from the case at hand. Unlike in the earlier two cases where the funds were not expressly restricted gifts, here, the endowments were restricted in perpetuity. The grant agreement in this case clearly stated that the funds were to be disbursed to OCB "only if [OCB] continue[d] to engage in charitable and educational activities." *Id.* at P64. The court in this case emphasized that there is no relevant authority that supported OCB's proposition that it was engaging in charitable, educational, or cultural activities by paying off its debt. The court in this case highlighted that in addition to being unrestricted, the bequests in *Boston Regional* and *Montclair National Bank and Trust* had vested in their respective charitable beneficiaries because these beneficiaries were actively pursuing their charitable purpose at the time of the testators' death. In contrast, OCB had ceased operations almost three years before the commencement of the lawsuit. Thus, although the court declined to allow restricted charitable gifts to be used to satisfy creditors' claims on the basis of a vesting argument, the analysis provided by the *Revis* court suggests that the court might have allowed unrestricted gifts or assets to be used for payment of debts in other settings, although clearly relying on the Charitable Trust Doctrine to shield restricted gifts.

In re Winsted Memorial Hosp., 249 B.R. 588, 594 (Bankr. D. Conn. 2000), is another case on point. There, the state attorney general moved to compel the trustee in bankruptcy of a charity to abandon charitable gifts to a Chapter 7 debtor-hospital in liquidation. The attorney general argued that the debtor had closed its doors and was no longer providing charitable services that the donors meant to support. The case hinged on the question of whether gifts vested in a debtor prior to the bankruptcy filing may be used to pay debts. The court decided that such gifts were generally included in the "property of the estate," subject only to the restriction that "they be applied to payment of debts incurred for the hospital's general charitable purposes while it was operating...." *Id.* at 596. To determine whether the use of gifts to pay debts is proper, the court suggested we pose the question: Is the proposed use proper had the bankruptcy not occurred? The court explained that the *Bishop College* court failed to address the question of "whether the intended use of the gifts was within the college's general charitable purposes." *Id.* at 594. Rather, the *Bishop College* decision was limited to rejecting the argument that a *mere* continued corporate existence is sufficient to entitle a bankrupt charity to the gifted assets. The *Winsted* court agreed with and elaborated on that rejection. More generally, the *Winsted* court concluded that a charitable organization that remained in existence may continue to receive and use charitable gifts, provided it applies such gifts in accordance with the intent of the donor, and the intent of the donor can include payment of debts incurred while the charity was operating prior to liquidation. Here, too, the court allows unrestricted gifts or assets to be used to satisfy creditor's claims, suggesting a view that the Charitable Trust Doctrine does not apply to such gifts or assets.

In this article, we provided an overview of the Charitable Trust Doctrine and two fact patterns in which it may arise (a slip-and-fall judgment creditor of a charity and a mortgage lender judgment creditor of a

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charity) and developed case law attempting to apply the Charitable Trust Doctrine to specific fact patterns both in bankruptcy and outside bankruptcy and concluded that the pattern these cases suggest is a view that the Charitable Trust Doctrine shields only restricted assets and gifts, albeit that courts may seek to find restrictions even in the absence of clear language in the instrument of gift in order to shield assets from claims. In this final part, we examine the application of the Charitable Trust Doctrine to mixed assets (i.e., assets derived from both restricted gifts and unrestricted gifts) and offer some conclusions and thoughts for practitioners.

Division of Assets Funded by Restricted and Unrestricted Assets

Where restricted and unrestricted gifts have been commingled, the issue of the application of the Charitable Trust Doctrine to the protection of such assets by a nonprofit from claims of creditors is particularly difficult. Of course, this is only of consequence in settings in which the court is not willing to protect unrestricted assets by application of the Charitable Trust Doctrine to unrestricted gifts, but, as noted above, case law does suggest that only restricted assets are so protected.

In re Parkview Hospital, 211 B.R. 619 (Bankr. N.D. Ohio 1997), is a case in point. There, the Ohio bankruptcy court considered whether a fund that consisted of commingled restricted and unrestricted gifts was a charitable trust excluded from the property of the estate and protected from creditors in a Chapter 11 reorganization bankruptcy proceeding. In doing so, the court relied on Ohio statutes and case law, as well as the Restatement (Second) of Trusts.

The court first considered whether there was a manifestation of intent by the donors to establish a charitable trust. Because of a lack of clear recordkeeping, the court was unable to differentiate the gifts donated with the specific intent of establishing a charitable trust (i.e., restricted gifts) and other gifts donated (i.e., unrestricted gifts). Despite this, the court decided that there was a general understanding between the donors and the nonprofit corporation to use the funds for a charitable purpose based on evidence of brochures used to solicit at least some of the gifts in the fund that used the term "restricted fund." Using this evidence, the court inferred that the intention of certain donors was to limit their gifts for a charitable purpose, and this was sufficient to create an imputed charitable trust as to those gifts (i.e., restricted by implication).

Because unrestricted gifts were also placed in the fund with no means of separating the two types of donations, the court then considered whether both types of gifts in the fund were protected by "charitable trust" status. There, the court relied on Ohio case law and statutes finding that Ohio nonprofit corporations had statutory authority to donate restricted gifts and could therefore make these donations to the funds for which they act as trustees. The court concluded that the inclusion of the unrestricted gifts in the fund simply operated as a restricted donation by the nonprofit corporation to the imputed charitable trust, treating the fund as if it were a separate trust entity. Thus, because all of the monies at issue were placed in the fund by either the nonprofit itself or by third-party donors with an intent to adhere to the restrictions imposed on the balance of the monies in the fund by other donors, the requisite intent to maintain a charitable trust was shown.

Throughout the opinion, the court stresses the significance of protecting charitable assets. First, in determining whether the charitable trust was created, it looked to several previous Ohio decisions emphasizing the public interest in supporting charities and the need to offer a "liberal and favorable consideration" when determining whether a charitable trust exists. *Id*. at 631-632. The court further stresses this point when responding to an allegation of improper use of funds within the fund, stating, "even were some improper use of funds to be shown, this Court would be reluctant to abrogate the intent of donors (who understood that this Fund was restricted for a charitable purpose) due only to the

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improprieties of the Fund's trustees." *Id*. at 638.

Although the court relied on state law and precedent to come to its decision, the decision indicates the court's unwillingness to make the fund available to creditors, as doing so would essentially deprive the nonprofit hospital of a large sum of charitable assets and the donors of their charitable intents. This implication is not explicit, but this case seems to provide a good example of how a court may protect unrestricted gifts that are commingled with restricted assets of the organization, albeit through what might appear to be the tortured logic of converting what might otherwise have been seen as unrestricted assets into restricted assets by imputing an intent to create a restricted gift by the mere act of comingled investing.

In re Catholic Diocese of Wilmington, Inc., 432 B.R. 135 (Bankr. D. Del. 2010), dealt with the division of assets held in a pooled investment account (PIA) between the Catholic Diocese of Wilmington and several of its parish affiliates. The Diocese, the debtor in a Chapter 11 bankruptcy reorganization proceeding, held assets in the PIA that were the debtor's property. The additional funds in the PIA belonging to parish affiliates were not considered property of the debtor's estate and were protected from the creditors of the debtor as the previous court decided that the Diocese had only acted as the trustee of these funds.

To trace the commingled funds within the PIA, the court adopted the lowest intermediate balance test (LIBT). Although it had not been adopted in the Third Circuit, the court recognized the use of this rule as a longstanding principle of trust law as well as a rule routinely applied by federal courts throughout the country. Under this rule:

> if the amount on deposit in the commingled fund has at all times equaled or exceeded the amount of the trust, the trust's funds will be returned in their full amount. Conversely, if the commingled fund has been depleted entirely, the trust is considered lost. Finally, if the commingled fund has been reduced "below the level of the trust fund but not depleted, the claimant is entitled to the lowest intermediate balance in the account."

Id. at 151 (citing *In re Dameron*, 155 F.3d 718, 724 (4th Cir. 1998) (internal citations omitted)). In applying the LIBT to the case at hand, the court was able to trace only the funds of one parish of the five participating in the PIA based on the evidence and records provided. Although the court was able to shield those funds from creditors of the debtor in bankruptcy, it held that the remaining parishes had failed to meet the burden of demonstrating the traceability of funds and thus any assets as to which they might have a claim were included in the property of the debtor's estate and available to satisfy claims of creditors.

In re Marve, 484 B.R. 735 (Bankr. N.D. Ind. 2013), presents another approach to dividing commingled funds in a bankruptcy proceeding. There, the court sought to distinguish the exempt and nonexempt funds held in the debtor's account by adopting and applying the "first-in, first-out method." Under this method, the court traces the exempt funds by looking at the account balance immediately preceding the deposit of the exempt funds. Then, the court will assume any funds in the account before such deposit had been used first when looking at the account balance at the time of the bankruptcy proceeding.

The court chose to adopt this method because it believed it "mirror[ed] reality" and is the best of the available methods, including the LIBT. While the LIBT is applied to preserve the maximum amount of exempt funds, that method does not always reflect the actual practices of deposits and withdrawals of the debtor. Rather, it would provide the most protection possible to the debtor's exempt funds in the trust. In choosing to apply the first-in, first-out method, the court reasoned that it was most appropriate, as it would rely solely on the timing of deposits and withdrawals, which in some cases will result in preserving

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funds and in other cases will not.

Although this case deals with the commingling of personal assets and an IRS earned income credit, which is exempt from inclusion in the property of the estate, it may still be applicable to a case involving restricted and unrestricted assets. In applying this method, the court in *Marve* relied solely on case law from varying jurisdictions in which courts were tasked with separating exempted assets from assets that were property of the estate. The court quoted a previous decision using the method, writing, "exemptions are to be construed liberally in favor of debtors," which seems to suggest this method can be applied to any exemption under section 541—including the exemption of restricted funds. *Id.* at 739. The court's decision to apply this test to an exemption that plays a similar role to charitable trusts may suggest that such a method can be applied to our current situation.

In fact, the court explicitly recognized and discussed the significance of exemptions such as the earned income credit when considering whether to apply the LIBT, writing that it "to some extent, alleviates the need for other social welfare payments to be made by the federal government, state and local governments." *Id.* at 740. The reasoning and policy considered by the court resemble those in support of the Charitable Trust Doctrine and the enforcement of exemptions on restricted charitable assets that makes it more likely that a similar approach could be taken in a case involving a charitable trust holding a restricted gift or asset. Because this is a personal bankruptcy case and does involve a charitable trust, the court may have been willing to apply a test that provided more protection to the debtor's assets, but the decision suggests that a charitable trust may be entitled to a division of assets that is more favorable to protecting the restricted charitable donations and assets—such as the LIBT.

Conclusion

From the muddle of case law described above, one can reach certain conclusions: (i) generally, courts recognize that the Charitable Trust Doctrine shields assets of a nonprofit charity that are donor restricted to a narrowly worded purpose; (ii) sometimes courts will impute a restriction on otherwise apparently unrestricted assets or on assets that derive from less than narrowly worded instruments of gift, particularly if doing so will allow a nonprofit charity to avoid insolvency or continue to operate; (iii) it does not appear that generally courts will extend this shield to unrestricted gift assets; and (iv) there is no meaningfully consistent precedent on the application of the shield that derives from the Charitable Trust Doctrine to assets that include or derive from both unrestricted and restricted sources.

Applying the scant case law that there is to the nursing home example set out above (and assuming for this purpose that the Home is located in a jurisdiction that has not directly addressed the issues), it is clear that neither the slip-and-fall judgment creditor nor a mortgage lender has a clear path to realizing a judgment on the assets of the charity that operates the Home. Most importantly, because realizing a judgment on the Home itself (and possibly on its reserves as well) would render the charity insolvent and incapable of continuing its exempt purpose, there is substantial authority that suggests that its assets, including the Home itself, would be shielded under the Charitable Trust Doctrine even if it required the court to impute restrictions on otherwise apparently unrestricted assets. Further, given that the Home property was acquired with a mix of expressly restricted gifts and gifts that may or may not have a limitation on use imputed to them, how the courts would enforce such a judgment lien on the Home itself is unclear. To force the sale of the Home to generate funds (if any portion of the funds used to acquire the Home was otherwise deemed available to satisfy claims of creditors) would frustrate the donative intent of those donors who did expressly impose restrictions and would render the charity insolvent. Thus, given the great deference that the majority of courts give to the Charitable Trust Doctrine, and given that the judgment lien in the slip-and-fall fact pattern does not arise out of the debt reasonably foreseeable to have been incurred for the operation of the Home, the likelihood of recovery by the slip-and-fall

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creditor against the Home itself seems remote. In the case of a claim of a mortgage lender, however, and in particular if the charity were not faced with bankruptcy if the claim was paid, the outcome is less clear. The lack of clarity in the law on these points invites legislative action, and although some states have adopted statutes shielding nonprofit assets from claims of creditors where insurance proceeds are available (*see, e.g.*, D.C. Code § 29-406.91; Md. Code Ann., Cts. & Jud. Proc. § 5-406), these statutes remain largely untested and fail to address whether unrestricted assets of a charity are available to satisfy contractual claims and how claims are to be satisfied where the available assets derive from a mix of restricted and unrestricted sources.

Further, the lack of clarity in this area suggests that lawyers representing charitable nonprofit corporations in mortgage loan transactions may wish to consider whether special qualifications to standard enforceability opinions are warranted, and lawyers representing lenders in such fact patterns may also wish to consider whether such qualifications render an enforceability opinion in this setting functionally moot.

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