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MEMORANDUM

DATE: April 7, 2000

TO: Members of the Nonprofit Forum

FROM: Daniel L. Kurtz

I have been asked to lead a discussion at next Thursday's meeting of the pending litigation between The Community Service Society and The New York Community Trust. To prepare you for the discussion, I am enclosing a copy of the October 1999 decision of Surrogate Preminger in Surrogate's Court, New York County, and the principal briefs on appeal, i.e., that of the Appellant, New York Community Trust; that of the Respondent, Community Service Society and the brief of the Attorney General. I have omitted the three reply briefs and the four amicus briefs. I do not intend to devote much, if any, time discussing the statutes of limitations and laches issues, and so those portions of this materials can be skipped unless you have some special interest.

I look forward to seeing you next week.

SURROGATE'S COURT: NEW YORK COUNTY

In the Matter of the Application of the Community Service Society of New York to Compel Barbara Scott Preiskel, Barry H. Garfinkel, Alberto Ibarguen, Anne Eristoff, Lulu C. Wang, Arthur G. Altschul, Bruce L. Ballard, M.D., Charlotte Moses Fischman, Robert M. Kaufman, William M. Evarts, Jr., Lorie A. Slutsky and Carroll L. Wainwright, Jr., as Members of the Distribution Committee of the New York Community Trust, and Chase Manhattan Bank, N.A., as Trustees under the Instruments made by

THE LAURA SPELMAN ROCKEFELLER MEMORIAL	File No. 4213/95
MORTON L. ADLER,	File No. 506/40
ALINE S. FRANK,	File No. 1275/54
NETTA L. FRANK,	File No. 1851/55
HENRY K.S. WILLIAMS	File No. 4212/95
LINDA A. GRIFFITH	File No. 1793/49

as Grantors, for the Benefit of the Community Service Society, to Make and Settle an Intermediate Account of their Proceedings as such Trustees, and for an Order Directing Distribution of Income.

PREMINGER, S.

This dispute involves consideration of the nature and scope of the power of a community foundation to re-direct a charitable fund under its control from a charity selected by the donor to a charity selected by the foundation. A threshold question is whether the statute of

limitations or the doctrine of laches bars this litigation.

A community foundation is a charitable, publicly supported, tax-exempt, autonomous institution organized to hold and administer funds endowed by many separate donors for the long-term benefit of a geographic area. There are approximately four to five hundred community foundations in the country today. The respondent here, the New York Community Trust ("NYCT"), is one of the oldest and largest.

Each fund within a community foundation is created pursuant to a separate gift instrument by which a donor (a) transfers assets to the foundation,[1] (b) sets forth the donor's wishes concerning the use of the assets and income of the fund, and (c) incorporates by reference the provisions of the community foundation's governing instrument. Funds held by a community foundation are the property of the foundation and not the designated charitable organization. The community foundation holds the assets (or in the case of a community foundation whose assets are held by trustee banks, the power to control the assets) subject to the fiduciary obligation to distribute the assets and their income in accordance with the governing instruments establishing the funds (the wills or inter vivos trusts of the donors) which all incorporate the NYCT's ultimate governing document, the Resolution and Declaration of Trust (the "Resolution").

Distribution of these charitable funds is handled by a governing board of the community

[1] A community foundation organized in trust form, as is the NYCT, does not itself hold assets. The assets are held in component trusts by banks and trust companies which invest the assets for the community foundation. In the case of the NYCT, a fund may be established with any of the many banks or trust companies that have adopted the governing instrument of the NYCT, its "Resolution and Declaration of Trust."

foundation which, in the case of the NYCT, is its Distribution Committee. The Distribution Committee is comprised of twelve members, one appointed by each of the Mayor of the City of New York, the President of the Association of the Bar of the City of New York, the Chairman of Lincoln Center for the Performing Arts, the Chief Judge of the United States Court of Appeals for the Second Circuit, the Chairman of the New York State Chamber of Commerce and Industry, and the President of the New York Academy of Medicine; five members appointed by the Trustee's Committee, a body composed of representatives of banks and trust companies adopting the NYCT Resolution; and the Director of the NYCT, who is an *ex officio* member of the Committee (Resolution, Art. V). The Committee has always consisted of distinguished New Yorkers with financial or philanthropic experience or interests.

A donor who establishes a fund with the NYCT may leave distribution decisions entirely to the discretion of the Distribution Committee or, as in the case of the funds here involved, may designate a specific charitable purpose or specific charitable organization to receive distributions. Any specific designation is subject to the Distribution Committee's variance power, which is recited in the Resolution. The Resolution, incorporated by reference in every instrument of gift by a donor to a community foundation, provides:

> any such expressed desire of the maker shall be respected and observed, subject, however, in every case to the condition that if and whenever it shall appear to the Distribution Committee ...that circumstances have so changed since the execution of the instrument containing any gift, grant, devise or bequest as to render unnecessary, undesirable, impractical or impossible a literal compliance with the terms of such instrument, said Committee... may at any time or from time to time direct the application of such gift, grant devise or bequest to such other public educational, charitable or benevolent purpose as, in their judgment, will most effectually accomplish the general purpose [of the NYCT], without

> regard to and free from any specific restriction, limitation, or direction contained in such instrument.

(Resolution, Art II).

The variance power is a defining element of the community foundation. Its purpose is to provide donors the opportunity to designate a specific charitable beneficiary or purpose and at the same time free them from "the grip of the dead hand," to ensure that their funds will remain effectively deployed regardless of changing circumstances. The variance power is broader than the doctrine of *cy pres*, which permits courts to salvage an ineffective charitable bequest only where achievement of the original purpose of the fund is impracticable or impossible and only by re-allocation of the funds in a manner that accomplishes the donor's general charitable purpose (EPTL 8-1.1[c]).[2]

The variance power is thought to be superior to *cy pres* because it vests discretion in a board of experts selected to represent a broad range of charitable interests rather than in courts which may have no such expertise (*See, Board of Trustees of the Museum of the American Indian, Heye Foundation v Board of Trustees of the Huntington Free Library and Reading Room*, 197 AD2d 64). Additionally, the variance power is broader than *cy pres* in that exercise of the variance power frees a fund of any restriction, allowing the community foundation to re-direct it to a wholly different purpose, whereas *cy pres* requires substantial adherence to the donor's original purpose (*See generally*, Turano, Practice Commentaries, McKinney's Cons Laws of NY, Book 17B, EPTL 8-1.1 at 389).

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[2]If the donor had a specific intent to benefit only the named charity and not a general charitable intent, then *cy pres* is unavailable (*Matter of Syracuse University*, 3 NY2d 665).

Tax law requires community foundations to possess the variance power in order to qualify for the favorable tax status afforded to such organizations. The governing body of the organization must be granted the sole discretion to exercise the variance power (26 CFR §1.170A-[9][e][11]). The community foundation is required to commit itself to exercise of the variance power, and to exercise the variance power where it has grounds to do so, or place at risk its tax-exempt status (*Id*).

With this background in mind, we turn to the facts. The petitioner, the Community Service Society ("CSS"), is a 153 year old social welfare agency that provides support and empowerment and direct relief to poor people within the City of New York. Direct service, work that affects an individual, is a large component of its work as well as research, lobbying and advocacy. The work of CSS, by all accounts, is and always has been widely respected by the NYCT and the philanthropic community.

In each of the six funds at issue here, CSS was named by the donor as a beneficiary for all or a specified percentage of the income of the fund. Thus, CSS was entitled to this income unless, by exercise of the variance power incorporated by reference into each of the trust instruments, NYCT was to terminate the donor's direction.

With respect to the Rockefeller Memorial, the instrument explicitly refers to the discretion of the Distribution Committee and provides that "[e]very decision made by the ...Distribution Committee...shall be binding and conclusive upon all persons, corporations or organizations which may at any time be beneficiaries of, or have any interest in, this Trust Fund."

For decades, CSS regularly received its specified income distributions from the trusts at

issue here, which were established between 1928 and 1970,[3] until NYCT exercised its variance power in 1971 to terminate CSS's interests in these funds.

In the period immediately preceding the NYCT's exercise of the variance power against CSS, both organizations experienced major changes that would affect their future dealings.

The NYCT, in 1968 or 1969, hired its first full time director, Herbert West. Prior to that time, the NYCT was operated on a part-time volunteer basis by Ralph Hayes. During Mr. Hayes' tenure, the establishment of designated funds as opposed to discretionary funds was encouraged, and the variance power was rarely exercised. Mr. West was known to prefer discretionary funds to funds that designated beneficiaries.

Also at that time the Tax Reform Act of 1969 was enacted. Among other things, it required a community foundation to have a variance power and to use it when appropriate in order to retain its tax favored status as a public charity. These events prompted the NYCT to conduct its first large scale review of designated funds[4], which resulted in the exercise of the variance power with respect to 25-30 percent of the NYCT's designated funds. The review began with the establishment, in January of 1971, of a Designated Grants Subcommittee whose purpose was to focus on the review of designated grants and to develop guidelines for the exercise of the variance power. At the next meeting of the Distribution Committee, in March,

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[3]One of the funds, the Griffith fund, established under a will executed in 1936 which did not come into the NYCT until 1970, never made distributions to CSS because the inception of the fund coincided with the exercise of the variance power against CSS.

[4]CSS's suggestion that the review was motivated by Mr. West's desire to free designated funds of their restrictions is without support in the record. In fact, review of designated funds was probably long overdue.

1971, the Distribution Committee adopted the Designated Grants Subcommittee's proposed guidelines for exercise of the variance power.

In the 1969-1971 period, CSS was also experiencing significant changes. A new General Director, Dr. James Emerson, joined CSS in 1969. One of his first responsibilities was to oversee CSS's decennial study report which was to set forth CSS's strategic plan to address poverty. This study report, issued in January 1971, announced that CSS would be changing from a family agency to a social agency, and that CSS would no longer use the service center style of approach but would move out of CSS centers and operate with community groups in an approach referred to by CSS as "shared power." Specifics, such as the areas of activity to be undertaken, were largely undefined and left to the discretion of the General Director. Dr. Emerson described the change as a "Copernican Revolution," fundamental in nature and not merely detail-oriented. This change at CSS was reported on the front page of the New York Times in an article headlined "Social Work Unit Changing Tactics - Community Service Society Ends Aid for Individuals - Plans Wider Role."

The Distribution Committee took its first major step relating to CSS at the March 1971 meeting when it adopted its Designated Grants Subcommittee's recommendation to suspend temporarily payments to CSS of distributions as to which it was a designated beneficiary. The principal basis for the decision to suspend was the New York Times article reporting on CSS's change of direction.

Although CSS does not dispute the appropriateness of this suspension,[5] it urges that some

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[5]Whether the Distribution Committee had authority to suspend distributions due to a designated beneficiary against whom it had not exercised the variance power is open to question.

further investigation to support a determination that the exercise of the variance power would be appropriate was necessary. Whether the NYCT did in fact obtain negative information during its subsequent investigation to support such a determination is an important issue in this dispute.

After the March 1971 suspension, the NYCT conducted a review of CSS. The review process was described at trial by Barbara Grants, the only individual on staff at the NYCT at the time of the 1971 variance power exercise who was available to testify at the trial. She did not testify to the discovery of any new negative information.

The review process, Ms. Grants testified, consisted of three components: (1) she reviewed the information submitted by the designated beneficiary in response to the NYCT's written inquiry, (2) she asked outside third parties for information, and (3) she reviewed the historical files of the NCYT relating to the designated beneficiary and to the founder. Documentary and testimonial evidence indicates that senior staff members of the NYCT were meeting with senior staff members of CSS during this March-September period to discuss specific project proposals and the "change in procedure" in distribution of funds. These meetings presumably were the source of further information about CSS's new directions.

Ms. Grants enumerated the specifics of the 1971 review of CSS to the extent she could recall them. She testified that she consulted the Contributors Information Bureau, an office of the Community Council of Greater New York that collected information on voluntary agencies

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The power to terminate might be deemed to include the lesser drastic power to suspend. On the other hand, allowing suspension without any obligation on the part of the Distribution Committee to justify the suspension would be an extraordinary power not mentioned in the Resolution or other instruments. The present dispute does not require determination of this issue.

in the City. With respect to annual reports of CSS, Ms. Grants testified that she did not remember reviewing them but that that would be something she would do in the ordinary course of a review. Furthermore, Ms. Grants testified that she met with Anne Poling, the Assistant General Director of CSS, in the summer of 1971 to learn how CSS was tackling a general operating deficit. Ms. Grants also testified that she reviewed CSS's study report announcing its new directions. Her contemporaneous memorandum concluded that:

> While this new program may appear revolutionary and even bad to some, one must consider the outstanding reputation and excellent track record of CSS as a leader in the field of social welfare. It is unlikely that over 100 years of experience and advanced thinking would fail them now.....If CSS is as successful in its new direction as it has been in the past, it will beneficially effect [sic] the lives of more individuals than ever possible under the old case work program.

The Distribution Committee held bi-monthly meetings which lasted less than two hours including lunch, and were not limited to discussions concerning CSS. Ms. Grants, who attended these meetings, testified that the decision about CSS consumed much of the discussion throughout the 1971 March-September period. She stated that uncertainty about the new directions concerned the Distribution Committee, but she did not elaborate as to any specific concerns. The meeting agendas, docket memos, and minutes similarly do not recite any areas of concern.

At its September, 1971 meeting, the Distribution Committee exercised the variance power and terminated CSS's interests in the funds at issue here on the grounds that continuation of payments to CSS was undesirable.

No reported decision, in New York or elsewhere, discusses the standard that governs a

community foundation's exercise of its variance power. There is a similar dearth of authority about the scope of a community foundation's discretion in applying such standard. In the absence of guidance by precedent, interpretation of the standard and definition of the scope of discretion should reflect a policy that maximizes the utility of community foundations to provide donors with the option of making their own choices of beneficiaries, while preserving the efficacy of their gifts should later circumstances undermine that choice. This, in turn, requires balancing deference to the expertise of the community foundation against the expectations of donors who designate particular charitable beneficiaries.

Deference to the expertise of the community foundation, and the Court's corresponding restraint in substituting its own judgment for that of the foundation, is necessary in order to reap the benefit of the diversity of expertise represented by the Distribution Committee. Furthermore, the variance power must be broad enough to give undesirability a meaning independent of impossibility, impracticability or lack of necessity. To hold otherwise would reduce the variance power to little more than a non-judicial *cy pres* authority, exercisable only in the most extreme circumstances. This would destroy the principal benefit of community foundations: flexibility to redeploy ineffectively allocated charitable assets in situations other than those where the identified charitable purpose is literally impossible or impracticable.

On the other hand, the standard that governs exercise of the variance power cannot be so flexible nor the latitude of the Distribution Committee in interpreting it so expansive as to permit wholesale reshuffling of charitable funds without reason. Discretion of this degree would be inconsistent with donors' designation of particular charitable beneficiaries or purposes. Defining the scope of discretion so broadly that it can ignore donors' designations would

discourage rather than encourage use of community foundations. Moreover, it would be unnecessary to fulfillment of the desire to maximize the efficient deployment of charitable funds.

Balancing these considerations, the Court concludes that a finding of undesirability, impracticality, impossibility or lack of necessity sufficient to exercise the variance power must be grounded in a change of circumstance that negatively affects the designated charity to such a degree that it would be likely to prompt a donor of the fund to re-direct it. Such a finding cannot be made by simply parroting the language of the Resolution. There must be identifiable negative details to support the determination of undesirability, impracticality, impossibility or lack of necessity which would be likely to cause the donor to withdraw her support. Such specificity is mandated by the nature of the community foundation arrangement. While the typical trust arrangement involves general judgments about discretionary distributions by a fiduciary selected by the donor, the variance power contemplates extreme action, termination of a perpetual gift, and its redirection to a field not necessarily contemplated by the donor.

Once the court is satisfied that the community foundation has used the above standard, maximum deference should be accorded the community foundation's determination of whether the standard has been met. This judicial deference to the community foundation's judgment parallels the scope of review of a trustee's exercise of discretion. Under that body of law, a court must give effect to the determination of a trustee vested with discretionary authority that is not subject to objective determination and may not substitute its own judgment (Bogert, Trusts & Trustees §560 at 191 [2d ed rev]; *see also, Matter of Clark*, 280 NY 155; *Matter of Carter*, 152 Misc 2d 599; *Matter of Leonard*, 6 Misc 2d 157; *Matter of Bouvier*, 205 Misc 974). If, however, the fiduciary abuses his discretion by acting dishonestly or with improper motive, by

failing to use his or her judgment, or by acting beyond the bounds of a reasonable judgment, the Court will intervene (*Matter of Stillman*, 107 Misc 2d 102, *citing* Restatement [Second] Trusts §187; *see also, Matter of Lyons*, 20 Misc 2d 717; *Matter of Emmons*, 165 Misc 192; *Manning v Sheehan*, 75 Misc 374).

CSS contends that the NYCT was negligent in its review of the facts. The Court disagrees. CSS's desire for the NYCT to have explored avenues of information other than those it did is not a shortcoming of the NYCT's review. The entitlement of beneficiaries is to have a fiduciary make a reasonable investigation of the facts; the beneficiary is not entitled to dictate the procedure for or substance of the investigation so long as the Court can, as it does here, find that the procedures used were adequate and reasonable (*Matter of Clark*, 280 NY 155; *Matter of Carter*, 152 Misc 2d 599). The Court declines the invitation of CSS and the Attorney General to dictate specific procedures for a community foundation's factual investigation.

The crux of this dispute is not the method of review or other procedural aspects of the process. It is whether the Distribution Committee, in 1971, after conducting its investigation uncovered sufficient negative information to support the determination that continuation of payments to CSS was undesirable. The principal argument relied on by the NYCT at trial was that the uncertainty caused by CSS's changed operating methods justified termination of funding. CSS contends that exercise of the variance power required more than uncertainty about the success of its new directions. The NYCT argues that uncertainty alone may constitute undesirability and thus serve as a basis for exercising the variance power.

The Court rejects the contention that uncertainty about future developments may be, in and of itself, undesirable. Change is inevitable. Uncertainty frequently accompanies change.

The premise of the variance power is that change will occur and that the Distribution Committee, composed of uniquely qualified individuals, will respond to change with a considered analysis of its impact on the funds under its control. A conclusion that uncertainty about the effect of change could justify exercise of the variance power would eliminate the obligation of the Distribution Committee to evaluate the consequences of the change. This would be a direct violation of the Resolution which requires not only a change in circumstances but one that renders continuation of distributions unnecessary, undesirable, impractical or impossible. It would also undermine the utility of community foundations. Instead of promoting flexibility and creativity, the variance power would discourage beneficiaries, through fear of losing funding, from making changes, and from healthy experimentation.

This does not mean that a Distribution Committee is required to continue payments to a designated beneficiary while it watches the organization put scarce charitable resources to ineffective use or that it must wait for an organization's demise before acting. Once a community foundation's Distribution Committee acquires information to support the conclusion that the change will jeopardize the ability of the organization to carry out its mission or otherwise adversely affect the organization or its work to such a degree that a donor of the fund would be likely to re-direct it, exercise of the variance power would be a proper response.

NYCT suggests that there may have been negative facts in existence at the time of its decision that would have supported exercise of the variance power and that this information may have been lost with the passage of time. Such unfounded speculation cannot justify the exercise of the variance power or cancel NYCTs obligation to engage in reasoning before concluding that a change is undesirable. (*See, Matter of Donner, NYLJ, Jan 7, 1991, at 26, col 4, aff'd 184 AD2d*

486, aff'd 82 NY2d 574.) Furthermore, the record that has survived is to the contrary. It is replete with praise and admiration by the NYCT itself for CSS both in word and in deed. For example, on the day the variance power was exercised, the Distribution Committee awarded CSS a large discretionary grant under cover of correspondence stating that the NYCT was "pleased to assist CSS in implementing its new directions." Nor did the NYCT decline any discretionary grant request of CSS at this time. Such support hardly bespeaks skepticism about CSS's changes. The Distribution Committee also decided to re-instate CSS as a designated beneficiary of a trust not in issue here shortly after it exercised the variance power as to the varied trusts. Payments to CSS under yet another trust, as to which the variance power was never exercised, were continued. These actions of the Distribution Committee are inconsistent with the contention that the changes at CSS were undesirable.

Alternative bases for exercise of the variance power suggested either at trial or in the contemporaneous record -- unionization of CSS's caseworkers, its operating deficit, its large endowment and the increase in government welfare spending through "Great Society" programs and otherwise -- neither alone nor together support the exercise of the variance power against CSS. Unionization created short-term difficulties that did not, and could not have been expected to, have any meaningful impact on the long-term future of CSS. CSS's operating deficit did not indicate anything negative about the organization's management but demonstrated only that the current needs of the organization outpaced its current receipts. In the face of this deficit, neither CSS's endowment nor expected receipts from government programs or other resources justified a conclusion that CSS had no need for the funds held for its benefit at the NYCT.

Accordingly, the Court finds the 1971 decision of the Distribution Committee to exercise

the variance power against CSS is unsupported. This conclusion also applies to the Rockefeller Trust notwithstanding the instrument's description of the Distribution Committee's discretion as "binding." While such an attempt by a donor to insulate a fiduciary's determination from judicial review has been said to constrain the Court's review of the reasonableness of the fiduciary's exercise of discretion (Restatement [Second] Trusts §187, comment [j]), it does not preclude reversal where, as here, the fiduciary misconstrues the scope of his authority and applies the incorrect standard (*See, Matter of Stillman, supra; Matter of Kaminester*, 16 Misc 2d 1071).

Before concluding that CSS's applications to compel accounts of the six funds in issue should be granted, the statute of limitations must be addressed. Prior to trial, the NYCT made several motions on statute of limitations grounds in this case (*E.g., Matter of Rockefeller et al*, NYLJ, June 17, 1996, at 30, col 6 [hereinafter "1996 op"]; *see also, Matter of Rockefeller*, June 10, 1998, at 28, col 4, *aff'd* ___ AD2d ___ [dismissing claims of another designated charity on limitations grounds]). The issue, discussed extensively in those opinions, need not be addressed at length again here.

The 1996 decision, issued prior to completion of discovery, held that the record as of that time established that CSS had notice of the NYCT's repudiation of the status of CSS as beneficiary entitled to a specified percentage of the income of the funds at issue here, but that the notice fell short of conveying to CSS notice of a complete termination of its interests (1996 op). The mixed signals given by the NYCT sufficed to commence the limitations period as to each year but failed to notify CSS that the 1971 action abrogated any special relationship between the NYCT and CSS so that CSS was relegated to the position of any other charity seeking discretionary funds.

The evidence presented at trial only buttresses the Court's conclusions reached in 1996. The testimony of former and current NYCT employees confirmed that CSS was accorded preferential treatment in review of grants. Furthermore, the substantial discretionary grants received by CSS after exercise of the variance power, its reinstated entitlement under one trust and unchallenged continuation under another, demonstrates that CSS was justified in understanding that its new position, while not as good as its prior status, was preferential to that of other charities. These transactions muddied the message of an otherwise clear repudiation, and thus there was no effective repudiation (*Matter of Barabash*, 31 NY2d 76). Accordingly, the statute of limitations does not bar the claims here for the period six years prior to the commencement of this proceeding.

Apart from the statute of limitations, the NYCT asserts that these proceedings are time barred based upon the equitable doctrine of laches. Laches is defined as "such neglect or omission to assert a right as, taken in conjunction with the lapse of time, more or less great, and other circumstances causing prejudice to an adverse party, operates as a bar in a court of equity" (*Id, citing* 2 Pomeroy, Equity Jurisprudence [5th ed], §419, pp 171-172). This affirmative defense is unavailable where the beneficiary is unaware of the fiduciary's repudiation (*Matter of Barabash, supra*).[6] Accordingly, the claim of laches fails for the same reason the statute of limitations claim fails.

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[6]It has been said that laches is available even where the fiduciary does not repudiate if termination of trust distributions should inform the beneficiary of the repudiation (III William F. Fratcher, Scott on Trusts §219.1 at 368 [4th ed]). Here, though automatic distributions stopped, discretionary distributions significantly increased. In light of the continued flow of funds, albeit in reduced amounts, the beneficiary cannot be charged with knowledge of repudiation.

In the absence of a limitations or laches defense, the applications of CSS to compel the NYCT to account are granted. Such accounts shall be rendered within 120 days of the date of the decree to be entered hereon.

Settle decree.

EP

SURROGATE

Dated: October 15 1999

To be Argued by:
ROY L. REARDON

Surrogate's Court, New York County Clerk's File Nos. 4213/95, P506/40, P1275/54, P1851/55, 4212/95 and P1793/49

New York Supreme Court

Appellate Division—First Department

In the Matter of the Application of the Community Service Society of New York to Compel Barbara Scott Preiskel, Barry H. Garfinkel, Alberto Ibargüen, Anne Eristoff, Lulu C. Wang, Arthur G. Altschul, Bruce L. Ballard, M.D., Charlotte Moses Fischman, Robert M. Kaufman, William M. Evarts, Jr., Lorie A. Slutsky and Carroll L. Wainwright, Jr., as Members of the Distribution Committee of the New York Community Trust, and Chase Manhattan Bank, N.A., as Trustees under the Instruments made by

THE LAURA SPELMAN ROCKEFELLER MEMORIAL, MORTON L. ADLER, ALINE S. FRANK, NETTA L. FRANK, HENRY K.S. WILLIAMS and LINDA A. GRIFFITH

as Grantors, for the Benefit of the Community Service Society, to Make and Settle an Intermediate Account of Their Proceedings as Such Trustees, and for an Order Directing Distribution of Income.

(For Continuation Of Caption See Next Page)

BRIEF FOR RESPONDENTS-APPELLANTS-CROSS-RESPONDENTS

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COMMUNITY SERVICE SOCIETY OF NEW YORK,

Petitioner-Respondent-Cross-Appellant,

– against –

THE NEW YORK COMMUNITY TRUST AND THE MEMBERS OF THE DISTRIBUTION COMMITTEE OF THE NEW YORK COMMUNITY TRUST,

Respondents-Appellants-Cross-Respondents,

– against –

ULTIMATE CHARITABLE BENEFICIARIES,

Respondent-Cross-Appellant.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES

OTHER AUTHORITIES

PRELIMINARY STATEMENT

The New York Community Trust ("NYCT"), one of the oldest community foundations in the United States, appeals from an adverse post-trial decision of Surrogate Eve Preminger dated October 15, 1999 (the "Decision"). The Decision is a case of first impression in this State and indeed, in the country, and if not reversed on the merits, will establish for the 555 community foundations throughout the United States the only judicial precedent concerning the variance power of community foundations and will chill their proper and innovative functioning.

The Decision requires NYCT to account to the Community Service Society ("CSS") for a 1971 decision of NYCT's Distribution Committee, its governing board, which terminated automatic distributions to CSS from six charitable trust funds. In so doing, the Decision purports to rewrite NYCT's governing constitution, its "Resolution and Declaration of Trust" (referred to herein as the "Resolution"), and eviscerates the discretion of NYCT's Distribution Committee to redirect a charitable gift in the light of changed circumstances that render the gift "unnecessary, undesirable, impractical or impossible." This discretion, technically known as the variance power, lies at the heart of all community foundations. It provides a flexibility in charitable giving that avoids "the grip of the dead hand" and the severe limitations of the *cy pres* doctrine.

The Surrogate expressly rejected the contentions by CSS that in 1971 NYCT had been negligent in its review of the facts. The Surrogate held that the Distribution Committee had made a "reasonable investigation of the facts." The Surrogate agreed that "maximum deference" should be accorded a community foundation's determination and rejected CSS's suggestion that NYCT had acted in bad faith. Indeed, she found that NYCT's procedures were "adequate and reasonable." These findings compel the conclusion that the Surrogate erred in not upholding the Distribution Committee's exercise of the variance power.

This Court should reverse the Decision in which the Surrogate judicially enacted an improper and unworkable standard for the exercise of the variance power, rewrote the governing instrument for community foundations, and, in contravention of established principles of law, substituted her judgment for that of a Distribution Committee comprised of eleven leading members of the New York City community, exercised 28 years ago.

The Decision also improperly rejected statute of limitations and laches defenses. However, in light of the precedential impact of this case, NYCT asks this Court not to decide the case solely on limitations grounds but to reach the merits. Only by reversing the substantive errors made by the Surrogate can this Court prevent the prejudicial effect of her decision on the administration of community foundations throughout the nation.

QUESTIONS PRESENTED

1. Did the Distribution Committee of NYCT properly exercise the variance power to terminate automatic distributions from six funds to CSS on the basis of evidence before it, including revolutionary change in 1971 in CSS's operations, the expansion of government assistance programs, and CSS's total uncertainty about the nature and scope of its future agenda?

The Surrogate erroneously held that the Distribution Committee did not properly exercise the variance power, holding, in effect, that it acted in an arbitrary and capricious manner – a conclusion that cannot be reconciled with her correct findings that the Distribution Committee had conducted a reasonable investigation of CSS and followed proper procedures in exercising the variance power.

2. Did the Surrogate err as a matter of law in substituting her judgment for that of the Distribution Committee?

The Surrogate improperly substituted her personal judgment for that exercised by the Distribution Committee in 1971.

3. Did the Surrogate err as a matter of law in not following and instead rewriting the standard for the exercise of the variance power expressly set forth in the Resolution, incorporated into each of the six donative instruments at issue and interpreted by the Distribution Committee in written Guidelines?

The Surrogate erroneously enunciated a standard for the exercise of the variance power that requires negative findings about the grantee and an ascertainment of the donor's likely intent, criteria that find no support whatsoever in the language of the Resolution.

4. Did the Surrogate err as a matter of law in overruling NYCT's statute of limitations and laches defenses where the unrefuted evidence established that CSS, with full knowledge of the exercise of the variance power in 1971, and thereafter receiving no automatic distributions from the subject funds, delayed 24 years before bringing this proceeding?

The Surrogate erroneously held that these proceedings were not barred by the statute of limitations or the doctrine of laches.

NATURE OF THE CASE

NYCT And The Variance Power

NYCT is a community foundation that was organized in 1924 to provide donors with a means by which charitable funds would be effectively devoted to the changing charitable needs of the community. Record on Appeal "R." at 112. As a community foundation, NYCT is a tax-exempt, grant-making organization which administers funds established by many individual donors for the long-term benefit of the inhabitants of New York City and its vicinity. *Id.* at 113-15. NYCT is the largest community foundation in the United States, distributing to charities income on funds in excess of $1 billion that are held by trustee banks selected by donors. *Id.* at 116-19.

The governing document of NYCT, which is organized as a trust, is its Resolution. *Id.* at 56. The governing body of NYCT is its Distribution Committee, which consists of leaders in the New York City community with pre-eminent reputations in the fields of finance, law, education, medicine and the arts.[1] *Id.* at 3832.

A donor who wishes to create a fund with NYCT must, as a condition of creating the fund, adopt and incorporate all of the provisions of the Resolution in the instrument of transfer. *Id.* at 60, *et seq.* The Resolution's provisions grant a trustee bank, selected by the donor, the investment responsibility over the fund assets. *Id.* The provisions charge the Distribution Committee of NYCT with the responsibilities with respect to the funds' charitable purposes, including the responsibility for grants to charitable recipients. *Id.* at 62.

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[1] In essence, the Distribution Committee is the equivalent of a Board of Directors. Currently one member of the Distribution Committee of NYCT is appointed by each of the following: the Mayor of New York, the President of the Association of the Bar of the City of New York, the Chairman of Lincoln Center for the Performing Arts, the Chief Judge of the United States Court of Appeals for the Second Circuit, the Chairman of the New York State Chamber of Commerce and Industry and the President of the New York Academy of Medicine. Five members of the Distribution Committee are appointed by a committee consisting of the Presidents of the trustee banks that have adopted the Resolution. NYCT's Executive Director also sits on the Distribution Committee. R. at 3832.

Each of the six funds which are the subject of this proceeding was a "designated fund" as to which the respective donor, at the time of the creation of the fund, expressed a desire to benefit a particular charitable recipient or charitable recipients, subject to the discretionary exercise of the NYCT's variance power. *Id.* at 60-61. This variance power is at the heart of these proceedings.

The terms of the variance power are set forth in the very first substantive provision of the Resolution. It provides that any expressed desire of a donor is subject *in every case* to the power of the Distribution Committee in their judgment to terminate automatic distributions and to redirect the distributions to other charitable causes:

> if and whenever it shall appear to the Distribution Committee that circumstances have so changed since the execution of the instrument containing any gift, grant, devise or bequest as to render *unnecessary, undesirable, impractical or impossible* a literal compliance with the terms of such instrument . . . .

Id. at 60 (emphasis added). Upon exercise of the variance power, the Distribution Committee has the discretionary power to:

> direct the application of such gift, grant, devise or bequest to such other public educational charitable or benevolent purpose as, *in their judgment*, will most effectually accomplish the general purpose expressed [herein] without regard to and free from any specific restriction, limitation or direction contained in such instrument.

Id. at 60-61 (emphasis added).

The variance power was one of the fundamental reasons why NYCT, and other community foundations throughout the United States, were created. *See id.* at 58-59. The variance power as expressed in the Resolution assures donors that their funds will always be effectively deployed to respond to the needs of the community regardless of inevitable changing circumstances. *Id.*

Prior Proceedings

This accounting proceeding was instituted in October 1995 by CSS, a 123-year old agency that up until 1971 had been a provider of direct relief to poor people in New York City. R. at 34. CSS challenges a determination made by NYCT's Distribution Committee almost 25 years earlier – in September 1971 – to exercise the variance power and redirect the income from six charitable trust funds under NYCT's control from CSS to other charities. *Id.* at 40. The six funds were: the Laura Spelman Rockefeller Memorial Fund; the Morton L. Adler Fund; the Aline S. Frank Fund; the Netta L. Frank Fund; the Henry K.S. Williams Fund; and the Linda A. Griffith Fund. These funds were established under trust indentures or wills created by the respective donors between 1928 and 1954. In each case the governing document incorporated the provisions of the Resolution and designated CSS (or a predecessor organization) either as a charitable recipient of fund income or as an adviser with respect to income to be devoted for a specific charitable purpose.

The Distribution Committee in the exercise of its discretion determined that a change in circumstances had occurred since the creation of the six trusts in such a way that the continuation of automatic distributions from the six funds to CSS was undesirable. This change included an admitted revolutionary change by CSS in the manner in which it functioned, an expansion of the government's role in public assistance, and a total uncertainty by CSS about the nature and scope of its future agenda. *Id.* at 2811, 3527.

In April 1996, The Salvation Army intervened in this proceeding and raised the same claim as CSS in respect of one of the charitable funds. *Id.* at 495. By decision filed June 5, 1998, the Surrogate dismissed this intervening petition on the ground of the statute of limitations. *Id.* at 1650. This Court affirmed by decision entered on March 4, 1999. *Salvation Army v. New York Community Trust*, 259 A.D.2d 289, 686 N.Y.S.2d 46 (1st Dep't 1999); R. at 30.

This proceeding went to trial before the Surrogate on October 20, 1998. Because of the passage of time, the court did not have the benefit of live testimony from any member of the 1971 Distribution Committee. Three principal issues were presented: (1) whether the Distribution Committee had abused its discretionary powers to terminate automatic distributions to CSS; (2) whether the proceeding was barred by the six-year statute of limitations applicable to accounting proceedings; and (3) whether the doctrine of laches precluded relief.

The Decision Appealed From

The Surrogate rendered her Decision on October 15, 1999. R. at 17(17). In that Decision the Surrogate properly described NYCT as "one of the oldest and largest" community foundations, holding funds that are "the property of the foundation and not the designated charitable organization" and subject to governing instruments "which all incorporate the NYCT's ultimate governing document, the Resolution . . . ." *Id.* at 17(2). The Surrogate described the composition of the Distribution Committee as "distinguished New Yorkers with financial or philanthropic experience or interests." *Id.* at 17(3).

The Decision properly identified the variance power as "a defining element of the community foundation" which is designed to assure donors "that their funds will remain effectively deployed regardless of changing circumstances." *Id.* at 17(4). In distinguishing the variance power from the *cy pres* doctrine, the Decision describes the variance power as "superior" to the extent that it "vests discretion in a board of experts selected to represent a broad range of charitable interests rather than in courts which may have no such expertise," and "broader" than *cy pres* in allowing the redirection of funds "to a wholly different purpose" rather than "substantial adherence to the donor's original purpose . . . ." *Id.* The Decision also acknowledged the Federal tax law requirement that the governing body of a community foundation has the "sole discretion to exercise the variance power" and must "commit itself" to do so "or place at risk its tax-exempt status." *Id.* at 17(5).

The Surrogate recognized the absence of any reported decision discussing the standard that governs a community foundation's exercise of its variance power, and explicitly recognized the significant policies at stake: the "deference to the expertise of the community foundation"; the court's "corresponding restraint in substituting its own judgment for that of the foundation"; the necessity "to reap the benefit of the diversity of expertise represented by the Distribution Committee"; the need to define the variance power broadly enough "to give undesirability a meaning independent of impossibility, impracticability or lack of necessity"; and the interest in not reducing "the variance power to little more than a non-judicial cy pres authority, exercisable only in the most extreme circumstances." *Id.* at 17(10).

Nevertheless, the Surrogate rewrote the variance power – without any legal basis whatsoever. She added a new requirement that community foundations must make a "finding" before exercising the variance power, dismissing the language of the Resolution by concluding that "[s]uch a finding cannot be made by simply parroting the language of the Resolution." *Id.* at 17(11). The Surrogate's new standard reads as follows:

> [T]he court concludes that a finding of undesirability, impracticality, impossibility or lack of necessity sufficient to exercise the variance power must be grounded in a change of circumstance that negatively affects the designated charity to such a degree that it would be likely to prompt a donor of the fund to redirect it. Such a finding cannot be made by simply parroting the language of the Resolution. There must be identifiable negative details to support the determination of undesirability, impracticality, impossibility or lack of necessity which would be likely to cause the donor to withdraw her support.

Id.

Acknowledging the "specificity" of this newly minted community foundation standard, the Surrogate felt it was "mandated by the nature of the community foundation arrangement." *Id.* According to the Surrogate, only after the court is satisfied that the community foundation has used the above standard does the additional standard for judicial review of a trustee's exercise of discretion come into play. The Decision recognizes that a

reviewing Court "may not substitute its own judgment" and may only correct abuses of discretion amounting to "acting dishonestly or with improper motive" or "acting beyond the bounds of a reasonable judgment." *Id.* at 17(11)-(12).

All the parties and the court below agreed that the actions of the Distribution Committee must be judged against an "abuse of discretion" standard. Yet, the Surrogate never found that the Distribution Committee abused its discretion. Instead, she failed to follow the standard for the exercise of the variance power and created a new, narrower standard, and she substituted her judgment for that of the Distribution Committee.

In reaching the merits, the Surrogate expressly found that the investigation of CSS made by NYCT in 1971 was "adequate and reasonable." *Id.* at 17(12). The Surrogate also rejected, as "without support in the record," CSS's argument that NYCT had terminated CSS's distributions in order to aggrandize its own power over charitable distributions in New York. *Id.* at 17(6) n.4, 17(14). The Record demonstrates that in 1971 NYCT exercised the variance power with respect to only about 25% of the funds under review, thus leaving 75% of the funds intact. R. at 2765-74, 2834, 2881, 2935-36, 3048, 3054-55. Accordingly, there is no question that the civic leaders who comprised NYCT's Distribution Committee in 1971 acted honestly and in good faith in making the decision to terminate automatic distributions to CSS from these six funds.

Although accepting the bedrock principle that a court is barred from substituting its judgment for that of a trustee, the Surrogate deviated from it during the course of her opinion, repeatedly taking issue with the reasoning of the Distribution Committee – although never holding that there was an abuse of discretion – and expressing her personal view that none of the grounds which influenced the Distribution Committee to act, either singly or collectively, justified the Committee's conclusion. *Id.* at 17(15). In so ruling, the Surrogate did, in fact,

substitute her judgment for that of the Committee, thus usurping the power vested exclusively in the Distribution Committee.

In addition, the Surrogate held that neither the statute of limitations nor laches barred the proceedings despite the undisputed fact that CSS was fully apprised in 1971 of NYCT's deliberations with respect to exercise of the variance power and has received no automatic distributions from the six subject trusts since 1971. *Id.* The Surrogate's holding was totally inexplicable, given her earlier ruling that the petition of The Salvation Army – a charity which had stood in the same position as CSS in 1971 – was time-barred.

The Surrogate directed NYCT to account within 120 days and entered a decree dated November 8, 1999 based upon her decision. *Id.* at 15. The decree was served with notice of entry on November 18, 1999. *Id.* at 14. Notice of Appeal was served on December 3, 1999. *Id.* at 6-7.

Proceedings on the decree have been stayed by order of the Surrogate dated January 5, 2000, pending final determination of this appeal. *Id.* at 27.

ARGUMENT

I. THE FACTS BEFORE THE DISTRIBUTION COMMITTEE IN 1971 FULLY SUPPORTED EXERCISE OF THE VARIANCE POWER WITH RESPECT TO CSS

A. The Distribution Committee Conducted An In-Depth Review Prior To Exercise Of The Variance Power.

In mid-1970, NYCT's Distribution Committee initiated an extensive review to determine the propriety of continuing to make automatic distributions to recipients of designated funds. Leading citizens of the time sat on the Committee, including Mrs. Laurance Rockefeller, Lindsley Kimball (an advisor to John D. Rockefeller, Jr.), Arthur G. Altschul (an investment banker with Goldman Sachs), Robert E. Blum (a director of Lincoln Center), as well as four prominent members of the bar: William Parsons of Milbank, Tweed, Hadley & McCloy, Francis Christy, name partner of Christy & Viener, Frank Detweiler of Cravath, Swaine & Moore and Whitney North Seymour of Simpson Thacher & Bartlett. R. at 2234-35, 2818.

In commencing its review, the Committee made plain that its sole purpose was "to make certain that [its] responsibilities [under the Resolution] were being faithfully carried out." *Id.* at 2730. Spurring the deliberations was the enactment of the Tax Reform Act of 1969, which was aimed at curtailing the power of donors to direct or influence the payment of funds from charitable trusts. *Id.* at 2225-31. The statute accorded tax advantages to publicly-supported organizations, such as NYCT and other community foundations, that had the discretionary power to redirect the payment of trust funds so as to serve public charitable purposes. *Id.* at 2226-29. One of the requirements imposed by the statute and regulations was that a community foundation actually deliberate with respect to the exercise of the variance power. *Id.*

As part of its deliberations, the Distribution Committee sent letters to all designated recipients, including CSS, specifically reiterating the terms of the Resolution, including the variance power, asking CSS to submit information about its then-current activities

and financial condition and alerting CSS to the potential exercise of the variance power. *Id.* at 2729-30. By late 1970 the Committee's review had "reached the state where the Committee [could] begin active determination of whether or not to continue [automatic] payments . . . ." *Id.* at 2742-43.

In early 1971, the Committee appointed a subcommittee, the Designated Grants Subcommittee, composed of Messrs. Christy, Detweiler and Parsons, to develop criteria by which to judge whether continued payments to designated payees are either "unnecessary or undesirable." *Id.* at 2765-66, 2778. The Subcommittee formulated written guidelines (the "Guidelines") recommending the continuation of automatic payments to designated payees unless one of two criteria applied:

> If the grant payment appears to be no longer needed by the designated organization, the case should be submitted to the Committee.
>
> If the grant payment is needed but conditions inside the agency or in their field of activity have so changed since the request was made as to possibly render further payments undesirable, the case should be submitted to the Distribution Committee.

Id. at 2816. The Guidelines elaborated on the circumstances under which continued compliance with the distribution provisions of a trust instrument would be deemed "undesirable," focusing on whether the operations of the designated recipient had "moved away from the problems which interested the founder," whether the "need for the organization's services may now be met by other organizations" or whether financial support is "now derived from other sources." *Id.* at 2817. The full Distribution Committee unanimously adopted the Subcommittee's recommended Guidelines in March 1971. *Id.* The Record amply shows that these factors were considered in the Distribution Committee's subsequent deliberations regarding the undesirability of continued automatic payments to CSS from the six funds.

B. Terminating A 123-Year Tradition Of Providing Casework Services To The Poor, CSS Proposed In Early 1971 A Self-Described "Copernican Revolution" With No Concrete Details For Implementation.

During the course of the Committee's deliberations, CSS publicly announced a Study Report, the subject of which was reported in a front-page article of the *New York Times* in late January, 1971. *Id.* at 3755. In its announcement CSS made plain that it would discontinue its traditional work of providing services to individuals and would undertake a "complete turnaround" – a "Copernican revolution" in the words of James Emerson, CSS's Executive Director at the time.[2] *Id.* at 3755. The Study Report in which CSS proposed the "Copernican revolution" was devoid of any details for its implementation, *id.* at 2035, 2037, and at trial, Emerson testified that CSS was "not yet clear about what specific work it will do." *Id.* at 2035. However, CSS's Study Report left no doubt about three critical facts.

First, needy individuals would no longer be CSS's clients. At trial, Emerson conceded under cross-examination that CSS intended to close counseling centers and to discharge caseworkers who had previously offered direct assistance to needy individuals. R. at 2037, 2047. Instead of serving individuals, CSS would serve "sick communities," however defined. *Id.* at 2046. In CSS's view, "potentially [the community] . . . might be the City itself," although "[p]ractically, this 'community' will probably never be larger than a borough and usually will be a block, a series of blocks, or a large neighborhood." *Id.* at 2787.

Second, CSS intended to "share power" with "community groups." *Id.* CSS conceded that in sharing power with such groups, "a certain degree of [CSS's] sovereignty [would be] lost . . . ." *Id.* at 2809. In short, "the request for help [would be] defined by the seeker not the counselor . . . ." *Id.*

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[2] Emerson explained that the term "Copernican Revolution" referred to Copernicus' rejection of the long-held belief that the earth was the center of the universe in favor of the view that the sun was the center of the universe. R. at 2038.

Finally, CSS had not decided who would receive funds from its treasury. CSS proposed merely to set in motion "[a] planning process [that would] allow for constant accumulation of new information, the assimilation of that information, and development of new plans in relation to that information." *Id.* at 2788.

Although CSS chose to publicize its change in the *New York Times* in late January, it did not transmit a copy of the Study Report to NYCT until late March 1971. In the interim, to avoid the continuation of automatic distributions to an entity in the midst of a revolutionary change and uncertainty as to where it would spend any money it received, the Designated Grants Subcommittee met and immediately recommended a suspension of automatic payments to CSS "pending clarification of its new role." *Id.* at 2817. At its meeting in March 1971, the Distribution Committee unanimously voted to accept the Subcommittee's recommendation to suspend payments to CSS "until the program changes of the Society have been learned and the Committee is assured that the Society is still in a position to use these funds in the manner intended by their donors." *Id.* at 2820; *see also id.* at 2856.

C. NYCT Fully Considered CSS's Proposed "Copernican Revolution" In Light Of The Operative Trust Instruments.

After reading the *New York Times* article announcing revolutionary changes at CSS and the absence of any specific plan on how it would operate in the future, NYCT's staff thoroughly reviewed and analyzed the Study Report and the trust instruments or wills establishing the six funds at issue. *Id.* at 2281-84. In advance of the Distribution Committee's meeting scheduled for September 17, 1971, NYCT staff prepared detailed docket memoranda setting forth the operative terms of each of the six trust instruments. *Id.* at 2341, 2393.

The Williams fund was one in which the donor designated a specific charitable purpose instead of an identifiable charitable recipient. The indenture provides for no direct payment of any money to CSS or any organization, expressing rather the settlor's desire that

income from the fund be paid to poor persons designated as "appropriate beneficiaries" by CSS's predecessor. *Id.* at 2588.

The Griffith and Adler governing documents contemplated that predecessors of CSS would be intermediaries in the redistribution of funds for specified purposes – the Griffith Will expressed the desire that income from the trust be devoted to "special cases of poverty and sickness," *id.* at 284; the Adler Will expressed the decedent's wish and desire that a predecessor of CSS expend trust income allotted to it in specified ratios for (1) the blind, (2) the aging, (3) convalescents in hospitals and (4) support of those desiring private or semiprivate rooms at hospitals. *Id.* at 2615, 2616.

Finally, the Rockefeller trust indenture supplemented the variance power, making plain that payments to designated charities were to be terminated once the "necessity for or usefulness of their work" is substantially lessened "under social conditions hereafter prevailing." *Id.* at 49-50.

In analyzing the six trusts, NYCT's staff addressed whether there had been (1) a "change of circumstances" since the execution of the governing instrument (2) that rendered "literal compliance with the terms of the [trust] instrument[s]" "unnecessary" or "undesirable" within the meaning of the Resolution and the recently adopted Guidelines established by the Distribution Committee. The staff's memoranda to the Committee explained that at the time the trusts were created, CSS's predecessor-organizations were performing casework for the individual poor and that governmental assistance programs were not extensive. The memoranda further analyzed (1) the growth in the intervening years of governmental assistance programs for the poor (including, *inter alia*, Social Security, Medicare, Medicaid, support for dependent children, welfare, job training, unemployment benefits and workmen's compensation), (2) CSS's decision essentially to terminate its prior casework services and (3) CSS's proposed community action work for the future. *Id.* at 2908.

On the basis of its in-depth analysis, NYCT's staff made the recommendation that the variance power be exercised with respect to all six funds and that thereafter monies in the funds should be applied for the improvement of health and welfare in New York City and its vicinity. *Id.*

D. The Distribution Committee Properly Exercised The Variance Power.

The Distribution Committee met on September 17, 1971 to consider the staff's recommendations. The crux of the issue was that in implementing its "Copernican revolution" with undefined "community" groups, CSS offered no assurance that distributions of funds from the six subject trusts would be used for any specific purpose and indeed no assurance that such distributions would be properly applied for the charitable purposes the donor wished. *Id.* at 3467, 3473-74. To provide a blank check to CSS – an organization that was changing its basic nature and ceding sovereignty to unidentified "community" groups – would have been an act of consummate imprudence.

After extensive deliberations, the Committee exercised the variance power with respect to all six trusts, converting them into semi-designated funds for the improvement of health and welfare in New York City. *Id.* In so doing, the Distribution Committee acted honestly, in good faith and with a reasonable basis to discharge its obligations under the Resolution to "most effectively assist, encourage and promote the well being of . . . inhabitants of the community comprising the City of New York and its vicinity . . . ." *Id.* at 62. In the ensuing years, NYCT distributed the income of the subject trusts for this purpose to a multitude of charities within New York City and its environs.

After exercise of the variance power, CSS was eligible to apply to NYCT for specific grants, as were all charities in the New York area. CSS had to provide justification for specific grant requests, explaining the details of each program, the persons who would benefit, the manner of implementation and the application of funds. *See id.* at 3076. NYCT evaluated

those requests in light of its stringent grant-making standards that it applied to all charities seeking funds in New York. *Id.* at 2167-68. Where CSS's proposals met NYCT's standards, NYCT made discretionary grants, as evidenced by a grant made at the same meeting as the exercise of the variance power with respect to CSS's collaboration with a federal housing rehabilitation project in the South Bronx. *Id.* at 2839-40.

It is axiomatic that "an appellate court has the power to review the record and make its own findings . . . where the record is complete and the essential facts can be readily and sufficiently established by a review of that record." *Weckstein v. Breitbart,* 111 A.D.2d 6, 8 (1st Dep't 1985). The factual record here compels the conclusion that the Distribution Committee properly exercised its discretion under the Resolution, ensuring that scarce charitable resources would be applied to promote the charitable purposes the donors intended.

II. THE SURROGATE PROPERLY HELD THAT NYCT DISCHARGED ITS OBLIGATION TO INVESTIGATE CSS

The law requires that a trustee utilize reasonable diligence in undertaking factual investigations required by a trust instrument. *In re Clark's Will*, 280 N.Y. 155, 163, 199 N.E.2d 1001, 1004 (1939). Here, the factual record leaves no doubt that NYCT's investigation of CSS was reasonable and that NYCT followed proper procedures, including the enunciation of Guidelines to assist in determining the propriety of continuing automatic distributions to designated payees. On the basis of the factual record, the Surrogate correctly concluded that the "procedures used [by NYCT in 1971] were adequate and reasonable . . . ." R. at 17(12).

In so holding, the Surrogate rejected CSS's argument at trial that it would have "desire[d] . . . NYCT to have explored avenues of information other than those it did." *Id.* In the court's words, "[t]he entitlement of beneficiaries is to have a fiduciary make a reasonable investigation of the facts; the beneficiary is not entitled to dictate the procedure for or substance of the investigation . . . ." *Id.* As this Court has held:

> [B]eneficiaries are given no power by the terms of the will creating the trust to interfere with the trustee in the administration of its trust and the law gives them no such power. The manner in which a trustee shall exercise his function rests ordinarily within his discretion.

Bulova Fund, Inc. v. Henshel, 31 A.D.2d 526, 526, 294 N.Y.S.2d 890, 891 (1st Dep't 1968) (quoting *City Bank Farmers' Trust Co. v. Smith*, 263 N.Y. 292, 295, 189 N.E.2d 222, 223 (1934)); *see also In re Del Drago's Estate*, 179 Misc. 383, 386, 36 N.Y.S.2d 811, 816 (Sur. Ct. N.Y. County 1942) (a trustee is "not required to seek approval" from the beneficiary in making trust decisions). The Surrogate's decision creates an oxymoron: she held that the Distribution Committee used "adequate and reasonable" procedures in exercising the variance power with respect to CSS, yet she then held that the Distribution Committee acted arbitrarily and capriciously – a point addressed in Point III, *infra*.

III. THE SURROGATE ERRED AS A MATTER OF LAW IN HOLDING IN ESSENCE THAT THE DISTRIBUTION COMMITTEE ABUSED ITS POWER IN EXERCISING THE VARIANCE POWER

Significantly, nowhere in the Surrogate's decision is there any finding that the Distribution Committee abused its discretion, the *sine qua non* to overturning its judgment. Inexplicably, the Surrogate nonetheless concluded that the Distribution Committee had improperly exercised the variance power. In so doing, the Surrogate misapplied a well-established body of law on which there was no dispute in the court below.

A. A Trustee's Exercise Of Discretion Must Be Sustained Absent Bad Faith Or Other Impropriety.

As the Surrogate noted, the general rule is that "a court must give effect to the determination of a trustee vested with discretionary authority . . . and may not substitute its own judgment." R. at 17(11); *see, e.g., In re Davis' Estates*, 54 Misc. 2d 1065, 1073, 284 N.Y.S.2d 414, 423 (Sur. Ct. N.Y. County 1967) ("[a] trustee's discretion . . . at least if exercised reasonably and in good faith, is not to be interfered with by the court."). This rule follows from

the fundamental principle that "it is not the court which has . . . discretion . . . it is the trustee who has . . . discretion." *Id.* at 1076, 284 N.Y.S.2d at 426. A court will intervene, however, as noted by the Surrogate, where "the fiduciary abuses his discretion by acting dishonestly or with improper motive, by failing to use his or her judgment, or by acting beyond the bounds of a reasonable judgment . . . ." R. at 17(11)-(12). CSS fully concurred in the application of these legal principles. In his summation, counsel for CSS acknowledged:

> We agree that the decision that was made here, the exercise of the variance power, was one to be made by the Distribution Committee and not by the Court. *We agreed [sic] that the standard of review of that decision is abuse of discretion or a finding of arbitrary action on the part of the Distribution Committee* and . . . we don't ask the Court simply to substitute its judgment for that of the Distribution Committee.

Id. at 2514-15 (emphasis added).

Charitable trusts require even greater deference to a trustee's judgment. For example, even in the vastly different context of the exercise of a court's *cy pres* power, this Court has recognized that the judiciary is ill-equipped to make judgments about the need, desirability or allocation of charitable bequests:

> The unsettling effect of . . . a promiscuous resort to the cy pres power can hardly be overstated; courts would be constantly involved in the redeployment of charitable assets, sanctioning their transfer from institution to institution upon the merest showing that the assets might be more usefully situated . . . . *Cy pres* may not be employed simply to promote what the court views as a worthy charitable agenda . . . .

Board of Trustees of Museum of Am. Indian v. Board of Trustees of Huntington Free Library & Reading Room, 197 A.D.2d 64, 81-82, 610 N.Y.S.2d 488, 499 (1st Dep't 1994).

Where a Surrogate substitutes her own judgment for that of a trustee, the courts uniformly have reversed. *See, e.g., Kavett v. Leavitt*, 23 N.Y.2d 579, 245 N.E.2d 718, 297 N.Y.S.2d 956 (1969) (reversing a lower court holding that limited a trustee's discretion in making determinations about the application of trust principal); *McManus v. McManus,* 62

A.D.2d 758, 407 N.Y.S.2d 180 (2d Dep't) (reversing Surrogate's imposition of a restriction on the trustee's discretion to terminate a trust), *aff'd*, 47 N.Y.2d 717 (1978); *Loew v. Hopke,* 23 A.D.2d 32, 258 N.Y.S.2d 539 (2d Dep't 1965) (reversing Surrogate's overriding of a trustee's judgment as to beneficiary's needs); *Kemp v. Paterson,* 4 A.D.2d 153, 156, 163 N.Y.S.2d 245, 248 (1st Dep't 1957) (the requirement that a trustee determine the beneficiary's "best interest" must be made by the trustee – not by the court).

B. The Surrogate Erred In Holding That The Distribution Committee Improperly Exercised The Variance Power.

Although the Surrogate properly articulated the abuse of discretion standard, R. at 17(5)-(6), she failed to adhere to that standard in reviewing the Distribution Committee's exercise of the variance power. The Surrogate made no finding that the Committee had been guilty of any dishonesty, bad faith or improper motive. The Surrogate expressly rejected, as "without support in the record," CSS's contention that the exercise of the variance power had been prompted by a desire of NYCT's then-Executive Director to free designated funds of restrictions so as to enhance NYCT's power over the distribution of charitable funds. R. at 17(6) n.4. Indeed, the Surrogate remarked that "review of designated funds was probably long overdue." *Id.* Moreover, the Surrogate took no issue with the fact that the Committee did have stated grounds for exercising the variance power – *i.e.*, uncertainty about CSS's future plans, the expanded role of government in public assistance, labor unrest, the CSS's shift from serving individuals as clients to serving an undefined "community" and the future application of charitable funds. *Id.* at 17(7).

The crux of the Surrogate's decision is a disagreement as to whether the grounds for the Distribution Committee's decision in 1971 were sufficient to meet her 1999 standard. Rather than "determining the propriety of the acts of" the Distribution Committee on the basis of "facts as they exist[ed] at the time of their occurrence, not aided or enlightened by" hindsight, *In*

re City Bank Farmers Trust Co., 270 A.D. 572, 576, 61 N.Y.S.2d 484, 487 (1st Dep't 1946) (quotation omitted), the Surrogate launched into a discussion of her personal views about the "inevitability" of "change" and "uncertainty" and the risk of discouraging designated recipients from "healthy experimentation." R. at 17(12)-(13). The Surrogate similarly rejected other bases relied upon by the Distribution Committee, such as labor unrest due to the unionization of CSS's caseworkers, its operating deficit and the expansion of government relief programs. *Id.* at 17(14). Once again expressing disagreement with the Distribution Committee, the Surrogate observed that unionization "could not have been expected to . . . have any meaningful impact on the long-term future of CSS," that the operating deficit "did not indicate anything negative" about CSS and that government programs had no bearing on CSS's need for funds. *Id.* The Surrogate, 28 years after the fact, thus had a different opinion from that of the 11 leading citizens who comprised the Distribution Committee.

In short, the decision below is premised on the Surrogate's personal views and policy proclivities, rather than appropriate deference to the discretion of the 1971 Distribution Committee as conferred by the Resolution. The Surrogate's disagreement with the Committee's judgment cannot, as a matter of law, constitute a basis for judicial interference. To hold otherwise would violate the fundamental principle that a discretionary power is to be exercised by the trustee, not by the court. *In re Clark's Will,* 257 N.Y. at 137, 177 N.E. at 398. The Surrogate's decision was clear error, requiring reversal by this Court.

IV. THE SURROGATE ERRED AS A MATTER OF LAW IN CREATING A STANDARD FOR THE DISTRIBUTION COMMITTEE'S EXERCISE OF THE VARIANCE POWER INCONSISTENT WITH THE STANDARD SET FORTH IN NYCT'S RESOLUTION

The Resolution is incorporated by reference in each of the trust instruments at issue in this litigation. It sets forth explicitly the standard for the exercise by the Distribution Committee of the variance power, authorizing the Committee to exercise the power when there is (1) a "change of circumstances" since the execution of the instrument (2) rendering "literal compliance with the terms of the instrument" "unnecessary, undesirable, impractical or impossible . . . ." R. at 60. Disregarding this clear language, the Surrogate undertook to enunciate "the standard that governs a community foundation's exercise of its variance power." *Id.* at 17(9)-(10). In so doing, the Surrogate proceeded to balance what she regarded as "policy" considerations, reasoning that "interpretation of the standard and definition of the scope of discretion should reflect a policy that maximizes the utility of community foundations . . . while preserving the efficacy of their gifts should later circumstances undermine that choice." *Id.* at 17(10). After balancing "policy" considerations, the Surrogate announced a totally new standard for the exercise of the variance power:

> [T]here must be identifiable negative details [about the designated charity] to support the determination of undesirability, impracticality, impossibility or lack of necessity which would be likely to cause the donor to withdraw her support.

Id. at 17(11).

This newly minted "standard" is clearly contrary to the Resolution. The Resolution does not link exercise of the variance power to any finding of "negative details" about a charity. Rather, the Resolution requires that "literal compliance" with the donative instrument be found "unnecessary, undesirable, impractical or impossible" – not that the recipient be deemed "undesirable" or otherwise having "negative" characteristics. *Id.* at 60. The Surrogate's standard would vitiate the purpose of the Resolution and undermine the fundamental

reason that community foundations exist. Indeed, exercise of the variance power may be particularly appropriate where a charity fully *succeeds* in achieving its purpose, thus rendering further grants unnecessary or undesirable.

The Surrogate's test for exercise of the variance power is flawed for a second reason. The Surrogate held that a "change of circumstance [must] negatively affect[] the designated charity to such a degree that it would be likely to prompt a donor of the fund to re-direct it." *Id.* at 17(11). Requiring a showing that the donor would have wished to redirect funds has no basis in the Resolution. By incorporating the Resolution, the donor expressly vests in the Distribution Committee the power to redirect income over time to promote charitable purposes – to "meet the changing needs for [charitable] gifts with flexibility in the power of distribution." *Id.* at 58. Such flexibility is the fundamental characteristic of a community foundation. Indeed, the Surrogate so recognized at the outset of her opinion when she observed that the variance power frees charitable funds from the "'grip of the dead hand.'" *Id.* at 17(4). As one court held in sustaining charitable gifts to the first community foundation, the organization's very purpose was "'to employ the principal or income, or both, for educational and charitable purposes in a broader and more useful manner in future years *than it is now possible to anticipate* [by the donor] . . . .'" *Linney v. Cleveland Trust Co.*, 165 N.E. 101, 105 (Ohio Ct. App. 1928) (citation omitted) (emphasis added); *see also Jeffreys v. International Trust Co.*, 48 P.2d 1019, 1022 (Colo. 1935).

By giving money to a community foundation which has the variance power, a donor relies on the judgment and expertise of the foundation to redirect the funds in case of a change of circumstances. If the donor intended the standard to rest on a change of circumstances that would have motivated him or her to reallocate the monies, the donor would have explicitly said so and would have chosen as a trustee a family member or friend who knew what the donor was likely to wish to do, or even a psychologist who had the skill to extrapolate what the donor

would have wished – instead of affirmatively giving such discretion to charitable community leaders such as the members of the Distribution Committee.

In sum, the Surrogate improperly propounded her own idiosyncratic "standard" for exercise of the variance power. A "trust instrument is to be construed as written . . . ." *Mercury Bay Boating Club Inc. v. San Diego Yacht Club,* 76 N.Y.2d 256, 267, 557 N.E.2d 87, 93, 557 N.Y.S.2d 851, 857 (1990). It is the trust instrument which defines the trustee's powers. *Colorado & S. Ry. Co. v. Blair,* 214 N.Y. 497, 507, 108 N.E. 840, 841 (1915). "[T]h[e] command of the testator is the law" that governs trust instruments. *In re Lloyd's Estate,* 292 N.Y. 280, 285, 54 N.E.2d 825, 828 (1944). The courts are bound by the terms of the trust instrument, *Matter of Trust Made by Gouraud,* 85 A.D.2d 342, 344, 448 N.Y.S.2d 186, 187 (1st Dep't 1982), and extrinsic considerations "can never serve to contradict the language of the trust indenture or to insert provisions for which there is no basis therein." *City Bank Farmers Trust Co. v. MacFadden,* 65 N.Y.S.2d 395, 396 (Sup. Ct. N.Y. County 1946); *see also In re Durand's Will,* 250 N.Y. 45, 53, 164 N.E. 737, 740 (1928); *In re Jackson's Will,* 282 A.D. 690, 122 N.Y.S.2d 550 (1st Dep't 1953). Accordingly, the Surrogate was bound to apply the Resolution as written, not to engraft upon it additional terms that she might believe required by reason of her perception of "policy" considerations. As this Court has emphasized, the law forecloses a Surrogate from "judicially impos[ing]" any "transmutation" upon an original trust instrument. *Gardiner v. United States Trust Co.,* 181 A.2d 91, 99, 587 N.Y.S.2d 609, 613 (1st Dep't 1992).

V. THE COURT BELOW ERRED AS A MATTER OF LAW IN NOT DISMISSING THE PETITIONS AS UNTIMELY

A. The Petitions Are Barred By The Six-Year Statute Of Limitations.

CSS, with knowledge of NYCT's repudiation of CSS's entitlement to distributions from the six subject funds, waited 24 years to commence these proceedings. Its exclusive purpose is to challenge NYCT's 1971 termination of *automatic* distributions from the six funds. The exclusive relief sought by CSS in these accounting proceedings is the recovery of monies CSS contends should have been paid *automatically* from the six funds since 1971, and the directive that NYCT distribute future monies from these funds *automatically* to CSS. *See, e.g.*, R. at 44-45. The Resolution provides for only two types of payments to be made to charities: either (1) automatic distributions pursuant to an expressed desire of a settlor or testator in a donative instrument or (2) grants made in the discretion of NYCT. Despite the clear, open repudiation by NYCT in 1971 of any further automatic distributions from the funds, and the unrefuted evidence and the Surrogate's finding of fact that CSS knew absolutely in 1971 that automatic payments from the funds were terminated, the Surrogate erroneously failed to dismiss these petitions as time-barred.

1. The Six-Year Statute Of Limitations Ran From The Time NYCT Openly Repudiated The Distribution Of Automatic Payments From The Six Funds In 1971.

The Surrogate held correctly that the statute of limitations governing these proceedings to compel an accounting is six years. R. at 522; *Matter of Rockefeller*, NYLJ, June 17, 1996 at 30, col. 6 ("1996 Decision"); *see* N.Y. C.P.L.R. § 213(1); *In re Barabash's Estate*, 31 N.Y.2d 76, 80, 286 N.E.2d 268, 270, 334 N.Y.S.2d 890, 893 (1972) ("the governing Statute of Limitations [for an accounting proceeding] is six years."), *reh'g denied*, 31 N.Y.2d 963, 341 N.Y.S.2d 1092 (1972). The Surrogate also held in a 1996 decision that the statute of limitations begins to run when a fiduciary repudiates the trust "openly, clearly and unequivocally." R. at

522 (citing *Barabash*, 31 N.Y.2d at 80, 286 N.E.2d at 270, 334 N.Y.S.2d at 893 ("The statutory period does not begin to run until the administrator has openly repudiated his obligation to administer the estate.") (citations omitted)). The Court of Appeals defined the standard for "open repudiation" in *Barabash*:

> The law requires proof of a repudiation by the fiduciary which is clear and made known to the beneficiaries . . . viewed in the light of the circumstances of the particular case.

31 N.Y.2d at 80, 286 N.E.2d at 270, 334 N.Y.S.2d at 893; *see also* R. at 522 ("No particular form of communication is required; whether an act or series of acts constitutes a repudiation depends on the particular circumstances.").

It is difficult to envision a case more clearly suited for dismissal on grounds of statute of limitations than this one. NYCT clearly and unequivocally communicated to CSS in 1971 that CSS no longer would be entitled to automatic distributions from any of the six trusts and that any future distributions would be solely in the discretion of the Distribution Committee in response to applications for grants. The Surrogate so held in her 1996 decision:

> [The communications between NYCT and CSS] establish that CSS . . . had notice of the NYCT's repudiation of the status of CSS . . . as beneficiar[y] entitled to a specific percentage of the income of the Rockefeller Trust, if not notice of the variance power per se. *Such notice constitutes a clear repudiation of entitlement.*

Id. at 526 (emphasis added).

The record on this question is clear. Beginning in 1969, CSS knew of NYCT's ongoing deliberations on whether to continue automatic payments from the funds. *See id.* at 519 (discussing process leading to exercise of variance power). At trial, CSS's director in 1971, Dr. Emerson, admitted: "I did understand there would no longer be automatic payments . . . ." *Id.* at 2025. He likewise conceded on cross-examination that he knew "there would no longer be automatic gifts" from the funds. *Id.* at 2051. CSS's Chairman of the Board in 1971 was also fully aware of the repudiation of automatic payments from the funds. *See id.* at 2825

(Memorandum dated May 12, 1971 reporting that NYCT Director West told CSS Chairman Mulreany, a senior partner at the prominent trusts & estates law firm of DeForest & Duer, that automatic distributions from the funds had been terminated); *id.* at 2236 (testimony by Carroll Wainwright, counsel to Distribution Committee, that NYCT Chairman Parsons discussed with Mulreany "the discontinuance of automatic designated payments to [CSS]," and "Bob Mulreany was not happy about it.").

In her 1996 Decision, the Surrogate rejected as "not persuasive" CSS's argument that the notification by NYCT was understood by CSS to be a mere change in procedure only and not substance. The Surrogate held:

> Notification of a change from automatic distributions to discretionary distributions cannot be considered a mere change in procedure because *discretion is the antithesis of entitlement.* Moreover, the response of . . . CSS . . . to the NYCT communications confirms [that CSS] understood that the NYCT's decision to exercise discretion could reduce the distributions from the Rockefeller Trust to [CSS].

Id. at 525 (emphasis added). Again, the evidence at trial is unrefuted on this point.

Dr. Emerson conceded that he knew that with the termination of automatic payments, CSS would be obliged to make requests for grants to NYCT and that NYCT had the power to deny the requests or to make any award that met NYCT's grant-making standards. *Id.* at 2051-52. Emerson knew that CSS would have to submit grant proposals to NYCT in order to receive funds and that NYCT had the power to "say yeah or nay." *Id.* at 2051-52.

Emerson, knowing full well that in order to receive funds CSS would have to submit an application, did so in mid-1971 – the first time CSS had ever sought a discretionary grant from NYCT. *Id.* at 2052. He requested funding for collaboration with the Jose de Diego-Beekman federal housing project in the South Bronx. NYCT granted the application for 48% of the amount requested. NYCT's letter announcing the discretionary award made no mention of

any entitlement of CSS to automatic income from the funds. In response, Emerson thanked NYCT for its "contribution" to CSS. *Id.* at 3602.

In sum, the admissions at trial of CSS's own witness and CSS's conduct indisputably establish that CSS knew in 1971 that any entitlement to distributions from the subject funds had been terminated.

2. NYCT's Dealings With CSS After 1971 Did Not "Muddy" The Clear, Open Repudiation Of Automatic Distributions To CSS.

In her 1996 Decision, the Surrogate held that the clear repudiation of CSS's entitlement to automatic distributions barred CSS's claims beyond the six years prior to the commencement of the proceedings. R. at 526. The court held, however, "[b]y failing to describe the change in status either by reference to the variance power or with similar words clearly conveying the complete termination of the interests of CSS" the repudiation "[could] be interpreted as an unauthorized, overzealous exercise of oversight responsibility by the NYCT falling short of complete termination of interest." *Id.* The Surrogate focused on the fact that CSS was invited to submit discretionary grant applications and that some of those applications were approved in whole or in part by the Distribution Committee over the ensuing years. Therefore, the Surrogate permitted CSS to pursue its claims for the six years immediately prior to the filing of the petitions, and into the future.

In her post-trial decision, the Surrogate acknowledged her 1996 holding that "[t]he mixed signals given by the NYCT sufficed to commence the limitations period as to each year but failed to notify CSS that the 1971 action abrogated any special relationship between the NYCT and CSS so that CSS was relegated to the position of any other charity seeking discretionary funds." R. at 17(15). The Surrogate held that post-1971 "transactions muddied the message of an otherwise clear repudiation . . . ." *Id.* at 17(16). In so ruling, the Surrogate erred by misinterpreting certain evidence and completely ignoring overwhelming evidence which

established conclusively that at all times after 1971 NYCT's actions reinforced the clear, open repudiation of CSS's entitlement to distributions from the six funds.

a. From 1971 Through The Present CSS Received No Automatic Payments From The Six Funds, No Payments Of Any Kind From Four Of The Funds, And Only Sporadic Discretionary Payments From Two Of The Funds.

The Surrogate's decision completely ignores the evidence of the cessation of automatic payments to CSS after 1971. Prior to 1971, NYCT made separate automatic distributions to CSS from each of the funds with transmittal notices reciting the terms of the operative trust instrument and the purpose specified by the donor for the use of the funds. *See, e.g.*, R. at 3556-57. After 1971, those checks stopped coming.

Indeed, CSS concedes that after 1971 it received *no payments of any kind* – automatic or discretionary – from the Rockefeller, Adler and two Frank trusts. *Id.* at 3813. Similarly, in 18 of the 24 years after 1971 and until the commencement of these proceedings, including 1974-1981, and 1984-1992, NYCT made *no payments of any kind* to CSS from the Griffith Trust. *Id.* In eleven of those years, including 1976, 1984-1992, and again in 1994, NYCT made *no payments of any kind* to CSS from the Williams Trusts. So, in 1976, and from 1984-1992, CSS received *zero* from any of the six trusts. *Id.*

Overlooking this undisputed evidence of cessation of automatic payments, the Surrogate focused on what she described as "substantial discretionary grants received by CSS after exercise of the variance power." *Id.* at 17(16). As a preliminary matter, the Surrogate's reasoning fails to take into account the inherent relationship between a community foundation and all charitable organizations. NYCT is a grant maker and CSS, as a not-for-profit charity, is a grant seeker. Even NYCT has never contended that it "repudiated" the right of CSS (or any other charity) to make a grant application – yet the Surrogate's ruling would appear to require a complete severance between NYCT and CSS in order to establish a "repudiation" sufficient to

trigger the statute of limitations. There is no legal or factual basis to conclude that the sporadic awarding of discretionary grants over decades – in this case from only two of the six trusts – rendered ambiguous the clear, open repudiation of CSS as a designated beneficiary entitled to automatic distributions.

The evidence here, however, reinforced rather than "muddied" the clear, open, unequivocal repudiation of CSS's entitlement to automatic payments from the six funds. Prior to 1971, CSS had never applied for a grant. In several of the ensuing years, NYCT made discretionary grants in response to specific grant applications by CSS, and then, only from the Williams and Griffith Trusts. When NYCT made an individual discretionary grant to CSS, there was no question that it was entirely discretionary. The transmittal letter sent to CSS specified the nature of the grant and the funds from which the money came, and expressly stated: "any funds not used for the purposes described in this letter will revert to the New York Community Trust." *See, e.g., id.* at 3554.

The Surrogate's reference to CSS being given "preferential treatment" is unsupported by the evidence. After 1971, CSS submitted grant applications for particular projects, like any prospective charitable grantee seeking discretionary funds. *Id.* at 2094, 3554-55. Some applications were granted; some were rejected. *See id.* at 3552-53. The funds distributed to CSS dropped precipitously from two of the trusts and, as described above, ceased altogether in the remaining four. From 1971 to 1995, discretionary grants to CSS from the funds averaged $28,360 per year – compared to an annual average of $100,748 in automatic payments from the same trusts in the decade preceding the exercise of the variance power. *Id.* at 3812, 3814. There was nothing muddied about the message given to CSS.

In responding to the denial of a grant application in 1974, CSS's Director protested to NYCT that "over the past three years perhaps $150,000 of income from [the Williams Trust] has not been allocated to us." *Id.* at 3533. Moreover, as the Surrogate noted in

her 1996 Decision, "[o]fficers of CSS considered the possibility of a lawsuit by CSS against the NYCT if CSS did not receive the income to which CSS believed it was entitled." *Id.* at 525. CSS considered a lawsuit in 1974, three years after the exercise of the variance power. No lawsuit was brought until 1995.

There is simply no basis for the Surrogate to have concluded that the occasional award of discretionary grants from two of the six funds, undermined the clear, open repudiation of CSS's entitlement to automatic distributions. As the Surrogate correctly held in her 1996 Decision, "discretion is the antithesis of entitlement." *Id.* at 525.

b. NYCT's Decision Not To Exercise The Variance Power In Two Other Trusts Where CSS Was A Designated Beneficiary Did Not Muddy The Repudiation Of CSS's Status Under The Six Trusts At Issue.

The Surrogate commented that ". . . [CSS's] reinstated entitlement under one trust [the Prince Trust] and unchallenged continuation under another [the Bonynge Fund], demonstrates that CSS was justified in understanding that its new position, while not as good as its prior status, was preferential to that of other charities." R. at 17(16). Again, the evidence is to the contrary and so is the law. There is no legal basis to conclude that CSS's status as a designated recipient of funds under one trust mutes or "muddies" the clear, open repudiation of CSS's status under six other trusts. As a factual matter, the "signals" given by NYCT with respect to the Prince Trust and the Bonynge Fund on the one hand, were in no way "mixed" with the clear message given to CSS with respect to the six trusts at issue, on the other hand.

(i) The Prince Trust

By will executed December 14, 1959, Melanie Prince Goldman left a portion of her estate to NYCT as Trustee with net income to be allocated, subject to the Resolution:

> FIVE PERCENT thereof to the COMMUNITY SERVICE ORGANIZATION OF NEW YORK CITY, in recognition of the work done . . . by my nephew Dr. Saul Scheidlinger.

R. at 2633. Dr. Scheidlinger, a Ph.D., was then employed by CSS. The Distribution Committee originally voted to exercise the variance power and terminate CSS's interest in the Prince Fund on September 17, 1991, at the same time it terminated CSS's interest in the six funds at issue. R. at 2935. On March 25, 1972, Dr. Scheidlinger, who was still employed by CSS, wrote to NYCT on the subject, reminding the Distribution Committee that his late aunt had left 5% of the annual income of the Prince Trust to CSS. *Id.* at 3037. At their July 27, 1972 meeting, the Distribution Committee reconsidered its decision and determined that the Prince Trust was intended to honor Dr. Scheidlinger personally and reinstated CSS as an income recipient of the Prince Fund. *Id.* at 3051 ("The Committee had intended to discontinue this designated grant but in view of the fact that Dr. Saul Scheidlinger is still living and feels deeply about its continuance, this designated grant was re-instated."); *see also id.* at 3046. The reversal of the decision of the Distribution Committee with respect to the Prince Trust did not in any way muddy the message with respect to the other six trusts.

(ii) M. Alida Bonynge Fund

The Surrogate's reference to CSS's "unchallenged continuation under another [fund]" is to the M. Alida Bonynge Fund. The reason there was no exercise of the variance power with respect to this fund was that the donative instrument did not provide for automatic distributions to CSS, but rather, provided for distribution to all or any of eight named charitable organizations, of which CSS was one. The decision rested with the discretion of the Distribution Committee. The Bonynge fund was established by the Will of Robert W. Bonynge who died September 22, 1939. His will gave to NYCT, subject to the Resolution, $57,700 with the desire that the net income should be devoted to the support of eight charitable institutions named or any one of them. R. at 2856-57. A predecessor of CSS was one of the eight. Noting the extremely small amounts of annual payments to CSS from this fund ($400 in 1970), *see id.* at 2857, the Distribution Committee, at its meeting of July 22, 1971, voted to change the administration of

the fund by giving NYCT's Executive Director discretion to suspend automatic payments to all eight named charitable organizations under the Bonynge Fund if "in his opinion . . . a more useful purpose would be served by making larger grants to one or more of the designated agencies." *Id.* at 2881. This was not an exercise of the variance power, but a change of procedure in administering the fund. The Surrogate's conclusion that the Distribution Committee's determination on the Bonynge Fund constituted "unchallenged continuation" of that fund and justified CSS's purported belief that it had not been terminated as an income grantee of the six funds in issue, is not justified by the evidence and inconsistent with the law. The test, as the Court of Appeals said in the *Barabash* case, is whether the grantee's complete termination from the trust was "made known to the beneficiar[y]." 31 N.Y.2d at 80, 286 N.E.2d at 270, 334 N.Y.S.2d at 893. CSS's understanding about its status as one of eight possible grantees of the Bonynge Fund had nothing to do with its understanding of the termination of its status as automatic recipient of income from the six funds in issue.

c. The Clear, Open Repudiation In This Case Is Readily Distinguishable From The Facts In *Barabash*.

In re Barabash's Estate, 31 N.Y.2d 76, 286 N.E.2d 268, 334 N.Y.S.2d 890 (1972), pitted the administrator of an estate against the decedent's children living in the Soviet Union. In 1963, the Administrator refused the demands of the beneficiaries to account. *See id.* at 79, 286 N.E.2d at 269, 334 N.Y.S.2d at 892. Counsel for the beneficiaries wrote a letter stating that "if an informal accounting wasn't coming within two weeks, resort to a compulsory accounting . . . would be necessary." *Id.* at 81, 286 N.E.2d at 270, 334 N.Y.S.2d at 894. Significantly, the Court of Appeals held, "[h]ad this been the end of the correspondence, we would agree . . . that a repudiation had occurred." *Id.* However, counsel for the administrator responded to the letter, hinting at a settlement offer and asking the beneficiaries for further documentation as to their status to maintain the accounting proceeding. *Id.* Counsel for the

administrator wrote several more similar letters over the years. *Id.* The Court of Appeals held that the actions by the administrator evinced an equivocal course of conduct subsequent to rejection of the children's position. *Id.* Accordingly, the Court of Appeals held that the statute of limitations did not begin to run. *Id.* Here, in contrast, there was never any equivocation in the repudiation message to CSS regarding the termination of its entitlement to automatic distributions from the six funds. While *Barabash* articulates the applicable legal test, its facts point to the opposite result here.

Indeed, this Court's decision in *Salvation Army v. New York Community Trust*, 259 A.D.2d 289, 686 N.Y.S.2d 46 (1st Dep't 1999), compels that result here. The evidence with respect to both The Salvation Army and CSS is equivalent in that in both cases there was no doubt that CSS and The Salvation Army knew in 1971 that automatic distributions had been terminated. In *Salvation Army,* the words "variance power" were not used. The same grounds that required dismissal of The Salvation Army's petition mandate dismissal of CSS's petitions.

3. The Policy Behind The Statute Of Limitations Applies.

This is not a case of resort to the statute of limitations as a mere technical defense. This is a case where the policy behind the statute of limitations is amply demonstrated. In the quarter century that passed since 1971, witnesses died, recollections faded damaging the quality of testimony that was available, and documents were destroyed by fire. If there ever were a case for applying the statute of limitations, this is that case.

B. The Petitions Should Be Dismissed Under The Doctrine Of Laches.

CSS invokes the equitable powers of the court by bringing these accounting proceedings. CSS's conduct must therefore be scrutinized under the equitable doctrine of laches. In *Barabash,* the Court of Appeals held that "the essential element of [laches] is delay prejudicial to the opposing party." 31 N.Y.2d at 81, 286 N.E.2d at 271, 334 N.Y.S.2d at 894. This Court similarly has held:

> Laches, in legal significance, is . . . delay that works a disadvantage to another . . . . The disadvantage may come from loss of evidence, . . . intervention of equities and other causes . . . . [W]hen a court sees negligence on one side and injury therefrom on the other, it is a ground for denial of relief.

Seligson v. Weiss, 222 A.D. 634, 638, 227 N.Y.S. 338, 342-43 (1st Dep't 1928) (quoting Pomeroy's Equitable Remedies vol. 1 § 21). The prejudice to NYCT here cannot be overstated. Despite clear evidence that CSS contemplated litigation against NYCT in 1974, CSS waited nearly a quarter century after receiving notice of the termination of its status as an automatic distributee of the six trusts to commence these proceedings. *See Schulz v. State*, 81 N.Y.2d 336, 348, 615 N.E.2d 953, 957, 599 N.Y.S.2d 469, 473 (1933) ("Because the effect of delay on the adverse party may be crucial, delays of even under a year have been held sufficient to establish laches.").

The Surrogate placed upon NYCT the burden of justifying the Distribution Committee's 1971 decision to terminate CSS as an income grantee of the six funds. The Surrogate required "sufficient negative information to support the determination that continuation of the payments to CSS was undesirable." R. at 17(12). The Surrogate ultimately found that "the 1971 decision of the Distribution Committee to exercise the variance power against CSS is unsupported." *Id.* at 17(14)-(15).

Although the Surrogate applied the statute of limitations to bar suit for the period of 1971-1989, NYCT was put in the position of defending in a 1998 trial a decision that had been made in 1971. The Distribution Committee members who made the decision were unavailable to appear at trial to defend their decision. Documents that may have shed light on the 1971 events had been lost due to the passage of time and a warehouse fire in 1984. *Id.* at 1072-73. Moreover, during each of the years since 1971, NYCT had distributed to other charities the portion of the income from the six funds which would have gone to CSS absent exercise of the

variance power. Now, NYCT is faced with a claim which it estimates to be nearly $3 million for the period beginning six years prior to commencement of these proceedings.

Had CSS brought a timely proceeding, NYCT would have had the benefit of a full documentary record. The members of the Distribution Committee who made the decision could have explained it at trial. Barbara Grants, a recent college graduate in 1971 and NYCT's most junior staff member, was the only witness that NYCT could produce in an attempt to meet the burden the Surrogate imposed on it to explain the variance decision. *Id.* at 17(8). Ms. Grants was not close to the decision-making process and, at trial, 27 years after the events, had a faded memory. The only testimony of a member of the 1971 Distribution Committee was that of William Parsons given by deposition shortly before he passed away from cancer. He too had faded recollections. In a timely proceeding the "search for truth" cannot be "impaired by the loss of evidence, whether by death . . . of witnesses, fading memories, disappearance of documents, or otherwise." *United States v. Kubrick*, 444 U.S. 111, 117 (1979). Instead of litigating promptly, CSS chose to delay for a generation, asking the Surrogate to judge the actions of eleven eminent men and women unavailable to offer a defense. For these reasons, CSS's challenge should be dismissed.

CONCLUSION

The Decision stands as an erroneous precedent for the hundreds of community foundations throughout the United States. If not reversed on the merits, the Decision will substantially chill the exercise of the variance power. While the Surrogate expressed concern about the "wholesale reshuffling of charitable funds without reason" by the governing boards of community foundations, that has obviously not occurred in New York or elsewhere in the nation given the absence of any reported decision or known case. NYCT and its distinguished Distribution Committee should be permitted to continue functioning under the language of the Resolution without the severe judicial restriction that the court below has imposed. NYCT asks

this Court to dismiss this proceeding and affirm the existing standard for exercise of the variance power as contained in NYCT's Resolution, the existing standard for judicial review adopted by all parties to this proceeding, and to affirm the Distribution Committee's 1971 exercise of the variance power. Because of the enormous public importance of the issues in this case, a decision on the merits is necessary in order to expunge from the record a precedent that will otherwise prejudice community foundations throughout the nation.

Dated: January 28, 2000

Respectfully submitted,

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NY2:#4337782

PRE-ARGUMENT STATEMENT, DATED DECEMBER 3, 1999 [1-5]

SUPREME COURT OF THE STATE OF NEW YORK
APPELLATE DIVISION, FIRST DEPARTMENT

In the Matter of the Application of the Community Service Society of New York to Compel Barbara Scott Preiskel, Barry H. Garfinkel, Alberto Ibarguen, Anne Eristoff, Lulu C. Wang, Arthur G. Altschul, Bruce L. Ballard, M.D., Charlotte Moses Fischman, Robert M. Kaufman, William M. Evarts, Jr., Lorie A. Slutsky and Carroll L. Wainwright, Jr., as Members of the Distribution Committee of The New York Community Trust, and Chase Manhattan Bank, N.A., as Trustee under the Instruments made by	New York County Surrogate's Court (Preminger, J.)
THE LAURA SPELMAN ROCKEFELLER MEMORIAL,	
MORTON L. ADLER,	File No. 4213/95
ALINE S. FRANK,	File No. 506/40
NETTA L. FRANK,	File No. 1275/54
HENRY K.S. WILLIAMS	File No. 1851/55
LINDA A. GRIFFITH	File No. 4212/95
as Grantors, for the Benefit of the Community Service Society, to Make and Settle an Intermediate Account of their Proceedings as such Trustees, and for an Order Directing Distribution of Income.	File No. 1793/49
Barbara Scott Preiskel, Barry H. Garfinkel, Alberto Ibarguen, Anne Eristoff, Lulu C. Wang, Arthur G. Altschul, Bruce L. Ballard, M.D., Charlotte Moses Fischman, Robert M. Kaufman, William M. Evarts, Jr., Lorie A. Slutsky and Carroll L. Wainwright, Jr., as	

Members of the Distribution Committee of The New York Community Trust,

Respondents-Appellants,

v.

Community Service Society of New York,

Petitioner-Respondent.

PRE-ARGUMENT STATEMENT

1. **Title Of The Action:** In the Matter of Community Service Society of New York v. The New York Community Trust, et al. to Compel an Accounting and Distribution of Income re The Laura Spelman Rockefeller Memorial, File No. 4213/95; Morton L. Adler Trust, File No. 506/40; Aline S. Frank Trust, File No. 1275/54; Netta L. Frank Trust, File No. 1851/55; Henry K.S. Williams Trust, File No. 4212/95; and Linda A. Griffith Trust, File No. 1793/49.

2. **Full Names Of Original Parties And Any Change In The Parties:** Community Service Society of New York, Barbara Scott Preiskel, Barry H. Garfinkel, Alberto Ibarguen, Anne Eristoff, Lulu C. Wang, Arthur G. Altschul, Bruce L. Ballard, M.D., Charlottes Moses Fischman, Robert M. Kaufman, William M. Evarts, Jr., Lorie A. Slutsky, Carroll L. Wainwright, Jr. as Members of the Distribution Committee, The New York Community Trust, and Chase Manhattan Bank, as Trustee.

3. **Name, Address And Telephone Number Of Counsel For Appellants:**

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4. **Name, Address And Telephone Number Of Counsel For Respondents:**

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120 Broadway
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5. **Court From Which Appeal Is Taken:** Surrogate's Court (Preminger, J.), New York County.

6. **State The Nature And Object Of The Cause Of Action Or Special Proceeding:** Petitioner Community Service Society of New York brought a proceeding to compel an accounting by The New York Community Trust of six funds administered by The New York Community Trust and for a distribution of income from those funds. Petitioner contended that the Distribution Committee of New York Community Trust wrongfully exercised its variance power in 1971 to terminate automatic distributions of income to Petitioner from those six funds and redirect that income to other charitable causes in the New York Metropolitan area.

7. **State The Results Reached In The Court Below:** The Surrogate's Court (Preminger, J.) after trial determined that the 1971 decision of the Distribution Committee was unjustified and ordered an accounting.

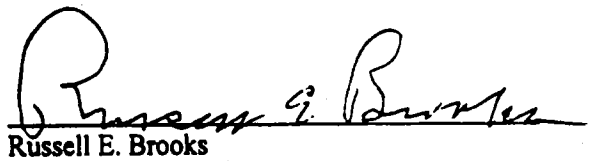
8. **State As Briefly As Possible The Grounds For Seeking A Reversal:** The Surrogate erred in not dismissing Petitioner's challenge to a 1971 transaction by application of the six-year statute of limitations or the doctrine of laches. Having wrongfully reached the merits of the controversy, the Surrogate substituted the Court's judgment for that of the 1971 governing board of The New York Community Trust, using the benefit of hindsight. Among other things, the Court created a judicial definition of the circumstances in which the variance power could be exercised, twenty-eight years after its actual exercise; ignored the language of The New York Community Trust's governing instrument; applied an erroneous standard of review; and placed the burden of proof on the Respondent. The New Community Trust's governing instrument provides that "if and whenever it appears to the Distribution Committee that circumstances have so changed since the execution of the instrument . . . to render unnecessary, undesirable, impractical or impossible a literal compliance with the terms of such instrument," the Distribution Committee may redirect the income by varying a donor's designation of recipients of funds. The Surrogate engrafted a new test – requiring a change of circumstances that negatively affects the designated charity to such a degree that it would be likely to prompt a donor of the fund to redirect it – and, then, concluded that the governing board's 1971 exercise of judgment and discretion was "unsupported". There were no findings that the governing board of The New York Community Trust acted dishonestly, or with improper motive or beyond the bounds of a reasonable judgment, and, therefore, no basis for judicial intervention nearly three decades after the events.

9. **Related Actions:** A companion proceeding was initiated by The Salvation Army seeking to overturn The New York Community Trust's decision in 1971 to exercise its variance power to terminate automatic distributions of income to The Salvation Army from the Laura P. Spelman Memorial. The Surrogate dismissed that proceeding after discovery by application of the six-year statute of limitations. The Surrogate's decision was affirmed by this court by decision entered March 4, 1999. *In re Application of the Community Service Society of New York, etc., The Laura Spelman Rockefeller Memorial, etc., The Salvation Army v. New York Community Trust, etc.*, No. 449 which held that the action was barred by the statute of limitations.

Dated: December 3,1999
New York, New York

Respectfully submitted,

MILBANK, TWEED, HADLEY & M^{c}CLOY LLP

By: 

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To be Argued by:
PHILIP L. GRAHAM, JR.

Surrogate's Court, New York County Clerk's File Nos. 4213/95, P506/40, P1275/54, P1851/55, 4212/95 and P1793/49

New York Supreme Court

Appellate Division– First Department

In the Matter of the Application of the Community Service Society of New York to Compel Barbara Scott Preiskel, Barry H. Garfinkel, Alberto Ibargüen, Anne Eristoff, Lulu C. Wang, Arthur G. Altschul, Bruce L. Ballard, M.D., Charlotte Moses Fischman, Robert M. Kaufman, William M. Evarts, Jr., Lorie A. Slutsky and Carroll L. Wainwright, Jr., as Members of the Distribution Committee of the New York Community Trust, and Chase Manhattan Bank, N.A. or Bankers Trust Company, as Trustees under the Instruments made by

THE LAURA SPELMAN ROCKEFELLER MEMORIAL, MORTON L. ADLER, ALINE S. FRANK, NETTA L. FRANK, HENRY K.S. WILLIAMS and LINDA A. GRIFFITH

as Grantors, for the Benefit of the Community Service Society, to Make and Settle an Intermediate Account of Their Proceedings as Such Trustees, and for an Order Directing Distribution of Income.

(For Continuation of Caption See Next Page)

BRIEF FOR PETITIONER-RESPONDENT-CROSS-APPELLANT

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COMMUNITY SERVICE SOCIETY OF NEW YORK,

Petitioner-Respondent-Cross-Appellant,

– against –

THE NEW YORK COMMUNITY TRUST AND THE MEMBERS OF THE DISTRIBUTION COMMITTEE OF THE NEW YORK COMMUNITY TRUST,

Respondents-Appellants-Cross-Respondents,

– against –

ULTIMATE CHARITABLE BENEFICIARIES,

Respondent-Cross-Appellant.

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES AND OTHER AUTHORITY

PRELIMINARY STATEMENT

In March 1971, the New York Community Trust ("NYCT") temporarily suspended payments to the Community Service Society of New York ("CSS") from six trusts under its administration that designated CSS as income beneficiary in perpetuity. Its action was based solely upon a newspaper article that inaccurately described changes in CSS's programs for assisting the poor in New York City. This suspension coincided with a broad review by NYCT that would result in the termination of trust payments to nearly one-third of NYCT's designated beneficiaries -- including many of the country's most prominent charities.

Six months after it first suspended CCS, the Distribution Committee of NYCT made this "temporary" suspension permanent, voting to terminate payments to CSS (and eight other charities on that day alone), in the course of a short luncheon meeting. In the intervening period, the only effort made to determine the accuracy of the newspaper article about CSS was some research by one NYCT staff member, who concluded that payments to CSS should continue because of the importance of CSS's work, its reputation and past record, and the potential value of its new programs. No other inquiries or research about CSS were undertaken except in reviewing a highly praised grant application from CSS. Indeed, on the very day that it voted to terminate CSS's rights on the ground that further trust payments to it were "undesirable," NYCT made a substantial grant to CSS -- from the very same trusts -- to fund one of the "revolutionary" programs that were the supposed basis for the termination decision. This endorsement of CSS's programs not only contradicted the supposed reason for the exercise of NYCT's variance power, but also obscured any indication CSS might have otherwise had that its rights were being abrogated.

In the ensuing years, NYCT continued to distribute funds to CSS, thus further undercutting the legitimacy of any claim that support of CSS and its programs was

undesirable, and at the same time sending a fatally confused message to CSS regarding its continuing status as a trust beneficiary.

On a trial record replete with detail about both CSS's programs and NYCT's conduct, the Surrogate determined that the Distribution Committee of NYCT, a fiduciary with all of the obligations of a trustee, had abused its discretion in terminating permanently rights to income granted by donors to CSS in perpetuity. Specifically, the Surrogate found that while NYCT had identified changes in CSS's programs, and had professed (at least at trial) to have been uncertain about the effect of those changes, this was not enough: proper exercise of the variance power required NYCT to determine that the identified changes rendered further payment to CSS undesirable. As the Surrogate then found, however, the evidence was all to the contrary. NYCT by its words and actions showed that it regarded CSS's new programs favorably and supported them generously. Because, as this conduct proved, NYCT did not believe the change at CSS was undesirable, it was an abuse of discretion to adopt it as the basis for exercise of the variance power.

The Surrogate further found, correctly, that CSS's claims were not time barred for the six years prior to filing its petitions, because CSS had never received the notice of a complete and unequivocal repudiation of all trust interests that New York law requires before it permits a trustee to assert a statute of limitations defense against its own beneficiary.

Virtually ignoring a factual record of investigative failure and judgmental abdication, NYCT and its *amici* engage in doomsday pronouncements, claiming that affirmance of the Surrogate's decision endangers the entire concept of community foundations. It does no such thing. The Surrogate carefully limited the scope of review of distribution committee

decisions to cases of abuse of discretion, and stated specifically that if the correct standard is used, and judgment is brought to bear upon the relevant issues, only the most extreme circumstances justify reversal of a fiduciary's decision. There is no basis in law or public policy however, for the *amici*'s extraordinary suggestion that -- unlike all other fiduciaries whose powers are limited by an articulated and reviewable standard -- the acts of a community trust must be upheld unless there is "compelling evidence of bad faith," regardless of how unreasonable its decision, whether it followed its own standards or whether it even exercised judgment in any respect. Whatever its historical roots, NYCT's Resolution and Declaration of Trust ("R&D") operates as a provision incorporated in a trust instrument, to be interpreted and reviewed as part of that instrument under the laws of this State.

Neither the Surrogate nor CSS has challenged the value of giving the governing body of a community trust broad discretion to act when changing circumstances render payments to a beneficiary impossible, impractical, unnecessary or undesirable. But when that broad (but by no means unlimited) discretion is abused, judicial review is both appropriate and necessary. The proven fact that NYCT abused its discretion in the case of CSS threatens neither the survival of community foundations generally nor the sound use of the variance power in proper cases. Nor should the profession of such unreasonable fears deter this Court from affirming the finding of the trial court that this particular fiduciary failed to exercise its discretion pursuant to its own standards in terminating the rights of CSS.

QUESTIONS PRESENTED

1. Was the Surrogate correct in holding that the conduct of NYCT in exercising its variance power is subject to judicial review on grounds applied generally in the judicial review of fiduciary conduct?

> The Surrogate correctly held that an exercise of the variance power by NYCT is subject to review for abuse of discretion, and that NYCT -- like all fiduciaries -- abuses its discretion not only when it acts in bad faith, but also when it fails to apply judgment in deciding the issues before the trustee, acts beyond the bounds of reasonable judgment, or misapplies its own internal standard for decision.

2. Was the Surrogate correct in finding that NYCT abused its discretion in exercising its variance power as to CSS, a named beneficiary of the six trusts at issue, on the ground that further payments to CSS were "undesirable"?

> The Surrogate correctly found that NYCT's Distribution Committee abused its discretion when it cut off CSS's status as a beneficiary of the trusts at issue without having identified how the supposed changes in circumstances made continued payments to CSS undesirable.

3. Was the Surrogate correct in finding that NYCT's own Resolution and Declaration of Trust ("R&D") by its express terms permits NYCT's Distribution Committee to exercise the variance power to cut off the charitable beneficiary of a trust only after it finds *both* that circumstances have changed *and* that such change affects negatively the desirability of continued payments of trust proceeds?

> The Surrogate correctly found that NYCT's R&D permits exercises of the variance power only when there is a change in circumstances that affects negatively the desirability of using trust assets to make further payments to a beneficiary.

4. Was the Surrogate correct in finding that NYCT failed clearly and unequivocally to repudiate CSS's status as a designated beneficiary of the six trusts at issue so that CSS's

claims for relief for the period beginning six years prior to the date CSS filed its petitions are not barred by the statute of limitations or laches?

The Surrogate correctly found that CSS's claims for the period beginning six years prior to the date CSS filed its petitions are not barred by the statute of limitations or laches where NYCT (i) failed to send CSS the notice letter sent to the other trust beneficiaries to advise them of the termination but instead endorsed in writing CSS's new programs; (ii) continued to treat CSS as a "preferential designee" of the six trusts; and (iii) continued to make significant distributions to CSS without referring to the variance exercise.

5. Did the Surrogate err in applying a six-year statute of limitations to CSS's claims for relief arising more than six years prior to filing the petition?

The Surrogate erred in limiting CSS's claims where it had never received fair notice that its rights were unequivocally and wholly repudiated.

STATEMENT OF THE CASE

Background[1/]

CSS is a 154-year old New York not-for-profit corporation that has uninterruptedly engaged in direct service to the poor (including cash grants, counseling and case work), community organization and advocacy programs, all aimed at improving the lives of poor people in New York City. R17(5); R1905-07, 1915-16, 1923 (Jones).

NYCT is a community foundation that administers charitable trusts established by individual donors. NYCT's Distribution Committee and a trustee bank named by the donor jointly administer each trust. R17(2-3); R60-61; R2670. The trustee banks and the Distribution Committee act as fiduciaries and are governed in the administration of each

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1/ Citations to the Record on Appeal appear as "R[page]." Where the identity of the witness whose trial testimony is being cited is unclear from the text, the citation appears as "R[page] (witness name)." NYCT's brief on appeal is cited as "App. Br. [page]." The brief of proposed *amicus curiae* the Council on Foundations is cited as "Council on Founds. Br. [page]"; the brief of proposed *amicus curiae* the Community Foundations is cited as "Community Founds. Br. [page]."

trust by the terms of the donor's will or deed of trust, including but not limited to the R&D, required by NYCT to be incorporated in each governing instrument. R17(2); R60-61.[2/]

Under NYCT's policies, donors have three choices. They may designate a particular beneficiary or beneficiaries that will receive trust income (creating a "designated fund"); may designate a particular area to which trust income will be devoted (a "field-of-interest fund"); or may leave the decision of how to distribute trust income to the discretion of the Distribution Committee (an "undesignated fund"). *See* R17(3); R2140 (Slutsky). A donor may create a designated fund in perpetuity or "for a definite . . . period" of time after which the funds become undesignated, and thus subject to the broad discretion of the Distribution Committee. R60.

Pursuant to the R&D, donor designations "shall be respected and observed" unless "circumstances have so changed since the execution of the instrument . . . as to render unnecessary, undesirable, impractical or impossible a literal compliance with the terms of such instrument." R60.[3/] Each of the six trusts at issue (collectively "the six trusts") was created by its donor as a designated fund and each explicitly designated CSS (or one of its predecessors) as an income beneficiary in perpetuity. R17(5).

[2/] For large trusts such as those at issue here, NYCT acts through a Distribution Committee whose individual members (named as Respondents here) are in effect individual trustees, exercising distribution discretion, while the bank trustees manage assets. *See* R17(2); R60-61; R2645.

[3/] NYCT and the *amici* correctly point out that under Treasury Regulation § 1.170A-9(e)(11)(v)(B), in order to qualify as a public charity, a community foundation must have the power to modify the restrictions or conditions of a trust instrument without the approval of any participating trustee, custodian, or agent if defined changes in circumstances occur. *See* App. Br. 12; Council on Founds. Br. 8; Community Founds. Br. 16. They fail to disclose that the last sentence of the very same regulation provides that any such exercise of its variance power by a community foundation may be "reviewable by an appropriate state authority," which obviously includes the courts of this State.

Procedural History

CSS initiated this Surrogate's Court proceeding in October 1995, claiming that NYCT had failed to make distributions to CSS from the six trusts at issue, and seeking an accounting and appropriate damages. R34-91. In 1996, the Surrogate (Preminger, J.) granted in part and denied in part a summary judgment motion by NYCT, holding that CSS's claims were not time barred for the period beginning six years prior to the date CSS filed its petitions, but were barred for all earlier years. R20-26; R514-28.[4/]

On October 15, 1999, following the completion of discovery and a five-day bench trial, the Surrogate issued an opinion (R17(1-17)) holding that NYCT's decision to terminate CSS's status as a designated beneficiary of the six trusts was unsupported. The Surrogate also reaffirmed her decision that CSS's claims for the period six years prior to the commencement of this proceeding were not barred by the statute of limitations or laches, but that CSS's claims for all prior years were barred. R17(15-17). By decree dated November 8, 1999, the Surrogate ordered NYCT to account within 120 days (R15-17), but then granted a stay of the accounting pending this appeal (R27-29).

Preliminary Note Regarding the Evidentiary Record

NYCT has chosen not to include in its brief a summary of the evidence bearing upon the exercise of the variance power by the Distribution Committee, instead implying that the passage of time made it impossible to develop an adequate evidentiary record. *See* App. Br.

[4/] In April 1996, the Surrogate permitted The Salvation Army to intervene in order to challenge NYCT's exercise of its variance power to terminate distributions to The Salvation Army from the Rockefeller Trust. R495-96. The Court later dismissed The Salvation Army's petition on statute of limitations grounds. R1650-55. This Court affirmed. *Salvation Army* v. *New York Community Trust*, 259 A.D.2d 289, 686 N.Y.S.2d 46 (1st Dep't 1999). As explained at pages 50-51, *infra*, the facts regarding The Salvation Army differ materially from those of CSS and the differing outcomes of the two motions are entirely consistent.

35. Despite NYCT's suggestion to the contrary, the parties introduced at trial contemporaneous documents and live testimony that provided ample evidence of the relevant events. The documentary record includes (i) agendas, issue summaries (called "docket memoranda") and ratified minutes for each of the relevant bi-monthly Distribution Committee meetings (*e.g.*, R2726; R2736-61; R2763-78; R2813-21; R2826-36; R2854-84; R2902-37)[5]; (ii) staff memoranda of meetings with third parties (*e.g.*, R2762; R2825; R2838); (iii) staff memoranda analyzing CSS's program change (R2822-24) and (iv) the relevant documents from NYCT's "fund files" for each of the six trusts (*e.g.*, R2886-88; R2891; R2894; 2895; R2896). NYCT has not pointed to any specific document, or type of document, that is no longer available; and there is no evidence suggesting gaps in the record of any kind.[6]

In addition, the Surrogate heard testimony from key participants, including Dr. James G. Emerson, CSS's chief executive officer from September 1969 to January 1973 (R1985-86); William Parsons (by deposition), a member of NYCT's Distribution Committee beginning in 1969, and its Chairman from 1971 to 1990 (R3385); Barbara Grants, the NYCT staff member specifically assigned to perform the initial fund review that ultimately led to the variances at issue here (R2262-63, 2313-14); and Carroll L. Wainwright, Jr., NYCT's outside counsel from 1970 to 1990 and a Distribution Committee member from 1990 to the present (R2232-33).

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[5] Docket memoranda were the only substantive documents sent to Distribution Committee members prior to meetings (R2481 (Grants)), and were, therefore, the Committee's principal, if not exclusive, source of information on the particulars of fund issues.

[6] In its brief NYCT refers to a "warehouse fire," implying a loss of relevant documents. App. Br. 35-36. There is no record evidence that such a fire occurred much less that anything relating to the six trusts was destroyed. As support for its assertion, NYCT cites an unadmitted (and obviously inadmissable) pretrial affidavit by NYCT Director Lorie Slutsky (R1072-73), who testified at trial but was not questioned by her counsel on this issue.

Three of the witnesses, Mr. Parsons, Mr. Wainwright and Ms. Grants, were present at the 1971 Distribution Committee meeting at which CSS was terminated. R2933.[7/]

The Facts Established at Trial

NYCT decides to review the status of all designated beneficiaries. Ralph Hayes, who established NYCT in 1924 and was its Director until 1967 or 1968, had encouraged donors to make designated (rather than undesignated or field of interest) grants. R17(6); R2136 (Slutsky); R2827; R3457 (Parsons). Soon after succeeding Mr. Hayes as Director, Herbert West (whose preference for undesignated funds is beyond dispute (R2069-74 (Whelan); R3424-25 (Parsons)), concluded that NYCT had a "problem" with its existing designated funds. R2762; R2825; *see also* R2317-18 (Grants); R2765. Reading between the lines, Mr. West's "problem" was that compliance with donor designations prevented NYCT from combining monies from separate trusts to support NYCT's preferred charitable goals. *See* R2072-74 (Whelan).

Mr. West and NYCT apparently decided in May 1970 to address this "problem" by initiating a review of all designated funds. *See* R2262-63 (Grants); R2726. This review, which took place over the course of 1971, resulted in NYCT exercising its variance power as to approximately one out of every three designated beneficiaries (*i.e.*, approximately 40 charities). *See* R2820; R2834-35; R2879-2883; R2934-36. Among those whose income was

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7/ There were also several individuals who submitted affidavits in connection with NYCT's motion for summary judgment, but whom NYCT chose not to depose or call as witnesses: Alvin Schorr (CSS General Director from 1973 to 1977), Bertram Beck (CSS's General Director from 1977 through 1985), Phillips Payson (NYCT staff member from 1962 to 1973), and James Dumpson (Assistant Director and then Vice President for Program Development and Evaluation of NYCT from 1976 to 1987). *See* R140; R291; R296; R398; R401. Furthermore, Mr. Parsons testified that, at the time of his deposition, at least two other members of the 1971 Distribution Committee (Robert Blum and Arthur Altschul) were still alive (in fact, Mr. Altschul is still a member of the Committee). R3438. None was deposed or called to testify.

cut off were some of the nation's oldest and most respected philanthropic institutions, including The Red Cross, The Salvation Army, The American Cancer Society, the NAACP and The *New York Times* Neediest Cases Fund. *See* R2834; R2908-17; R2934-35.[8/]

The review process. At its May 1970 meeting, the Distribution Committee decided to include with 1970 distribution checks a letter to beneficiaries requesting information about their activities and financial status. R2726-28. The letter also stated, "[t]his review is not intended in any way to imply any criticism of the activities of your organization. It is simply a conscientious effort on the part of our Committee to make certain that its responsibilities in the handling of charitable funds are being faithfully carried out." R2728.[9/]

After May, NYCT's minutes, agendas and docket memoranda show no progress regarding variance exercises until the November 1970 Distribution Committee meeting, where there was a discussion of procedures that should be followed in exercising the variance power:

> It was agreed that there should be some intermediate step between continuance or discontinuance. If a designated payee were moved to this intermediate stage, payments would be suspended but *the organization would be given ample opportunity to submit further evidence for continuance*. It was also agreed that even this step should require approval in two successive meetings of the Committee before being implemented, to avoid any intemperate haste in suspension.

8/ NYCT correctly points out that the adoption of Treasury Regulation § 1.170A-9(e)(11)(v)(B) made periodic review of trust instruments desirable. Nothing in the regulations required that the variance power actually be exercised, however, and NYCT denied that any exercise was undertaken for the purpose of establishing compliance with treasury regulation requirements. R2238-39 (Wainwright). Indeed, NYCT has almost never used the variance power since its 1971 sweep. *See* R2075 (Whelan); R2172-75 (Slutsky); R3407.

9/ The inquiry letter to CSS (which actually referred only to the Williams Trust) was dated May 25, 1970. R2729-30. CSS responded promptly by letter to Mr. West dated June 19, 1970 (R2732-33), and never received any indication that its response was unsatisfactory. CSS had received similar inquiries about the Williams Trust previously, and had provided NYCT extensive information about how Williams Trust monies were being used for the "material relief" of poverty as the donor instructed. *See, e.g.*, R3284; R3285; R3522.

R2737 (emphasis added). As shown below, NYCT often failed to follow these procedures, and did not do so in the case of CSS. *See, e.g., infra*, at 14, 37 n.27.

CSS completes its own program review. By happenstance, NYCT's review of designated funds coincided with CSS's completion in January 1971 of its own decennial program review and self-evaluation. R1933-34 (Jones); R1996-2000 (Emerson); R3177. This review resulted in a "Study Committee Report" (R2779-810) being submitted to the Board of Trustees of CSS, along with three back-up volumes containing additional studies, surveys, position statements and statistics. R1995 (Jones); R3177. The Report included a comprehensive analysis of the social and economic problems in New York City in order to determine how CSS could maximize its own effectiveness by following certain "new directions" in delivering services to the poor of New York City. R3177-79.

When issued, the CSS Study Committee Report received publicity both in specialized journals and the general press. *See, e.g.*, R2811-12; R2843-50. The Report was to some extent misinterpreted in the general press and attacked by persons within the social services community whose livelihood or traditional way of doing business was challenged by it. *See* R2014-15 (Emerson); R2844. A principal point -- which CSS's Director characterized as "revolutionary" -- was that CSS's traditional welfare casework activities should be changed by moving caseworkers from CSS's four offices to field positions at various housing projects and other centers of need in New York City. R2002-03, 2056 (Emerson); R3755.

As will be shown, for NYCT, the Study Committee Report presented a serendipitous opportunity: NYCT was able to misinterpret the report to mean that CSS intended to cease "direct service to individuals." R2822. As NYCT's counsel ultimately conceded at trial, however, the Study Committee Report states clearly that CSS did not intend to eliminate

direct services and, in fact, at all times continued to provide such services. R1983; *see infra*, at 23.[10/]

NYCT decides to suspend payments to CSS. In January 1971, the Distribution Committee established a "Designated Grants Sub-Committee" ("Sub-Committee") to develop variance criteria "by which to judge whether continued payments to designated payees are either 'unnecessary' or 'undesirable'." R2765-66; R2778.

Apparently as one of its first acts, the Sub-Committee then "recommended that further payments to [CSS] should be suspended pending clarification of its new role, and how it contrasts with the operations which interested various founders." R2817. As Ms. Grants conceded at trial, this recommendation was based solely on a *New York Times* article (R2347), which had (erroneously) announced that CSS would "end 122 years of family casework and individual counselling" (R2811). The Sub-Committee's decision to recommend "suspension" of payments to CSS was made without inquiry of CSS and before NYCT had received a copy of CSS's Study Committee Report. *See* R2345-47, 2354 (Grants); R2817; R3532.[11/]

At its next meeting (March 1971), the full Distribution Committee adopted the Sub-Committee's recommendation to suspend payments to CSS "until the program changes of

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[10/] The term "direct service" generally refers to all kinds of service to individuals, including casework, counseling, cash payments, payments for third party services (such as summer camps, tuition and homemaker services) and gifts of food, supplies, tools, etc. *See* R17(5); R1910-12 (Jones). The November 1970 docket memorandum reflects NYCT's concurrence in the view that any program or activity aimed at providing immediate relief is "direct service," while advocacy and research-based projects are "indirect service." R2751.

[11/] NYCT's brief implies that CSS was derelict in not providing NYCT with a copy of its January 27 Report the moment it came out. *See* App. Br. 15. It was conceded at trial, however, that the seven week time lag had nothing to do with NYCT's decision (actually made 6 months later) and did not impede its deliberative process. R2348-49 (Grants). In other words, the reference is a red herring.

[CSS] have been learned and the Committee is assured that [CSS] is still in a position to use these funds in the manner intended by their donors." R2820.

An NYCT staff member finally reads the Study Committee Report and concludes that payments to CSS should continue. Sometime in late March or early April, Ms. Grants reviewed the actual CSS Study Committee Report and concluded that NYCT should *not* exercise the variance power as to CSS with regard to all or most of the trusts designating CSS as a beneficiary. 2352-56 (Grants); R2824. In her April 6, 1971 "Summary of the Report of the Study Committee of the CSS" (R2822), Ms. Grants stated:

> [O]ne must consider the outstanding reputation and excellent track record of CSS as a leader in the field of social welfare. It is unlikely that over 100 years of experience and advanced thinking would fail them now .... CSS has chosen to marshal its total energies to the area which potentially can [affect] the maximum number of people who need help. If CSS is as successful in its new direction as it has been in the past, it will beneficially [affect] the lives of more individuals than ever possible under the old casework program.

Ms. Grants concluded that "[w]ith the possible exceptions of the Williams and Adler funds, it would appear from the ... extracts [from trust instruments] that the new direction of CSS would not hamper continuation of annual grants, if, in the opinion of the Distribution Committee, CSS's work continues to be of high quality." R2824. Not surprisingly, Ms. Grants testified that, at that time she wrote her report, she "wanted to see [NYCT] continue working with CSS" and had urged the staff to continue the relationship. R2354. Mr. West (the champion of undesignated funds), however, was unpersuaded, and apparently never sent Ms. Grants's report to the Distribution Committee. R2281 (Grants).

NYCT demonstrates its fundamental misunderstanding of the scope of the variance power. At its next meeting (May 1971) the Distribution Committee embarked upon the actual process of exercising the variance power, starting with the Bailey Fund and its 24 designees. R2834. After proposing that six of the 24 beneficiaries continue to receive payments, the staff's docket memorandum recommends that payments to three others (The American Red Cross, The American Foundation for the Blind and The Boy Scouts of America) be terminated based on previously adopted guidelines. R2828. The docket memorandum then recommends adoption of the following additional guideline:

> The Committee, in compliance with the designation of a donor, will pay annually a grant which is comparatively insignificant in amount to an organization, otherwise qualified, for its general purposes for at least nine years, after which payments may be suspended.

R2829. The memorandum makes no effort to reconcile its nine year cut off proposal with the requirement of the R&D that the donor's designation "shall be respected and observed" unless circumstances have so changed as to render further payments unnecessary, undesirable, impractical or impossible or to explain why a donor's intentions should simply be ignored after nine years. It merely notes that, if this additional guideline were adopted, payments to an additional 13 Bailey beneficiaries "would be subject to suspension." R2829.

At its May 1971 meeting, the Distribution Committee followed the staff's recommendation to suspend payment to the 13 additional Bailey Trust designees. Among those cut off because payments were found unnecessary or undesirable were The American Cancer Society and The American Heart Association. R2829; R2834-35. Echoing the staff view that NYCT knew better than the donor how to apply the donor's bequest, the Distribution Committee minutes note that "[t]hese funds will be allocated . . . to other

projects which, *in the opinion of the Committee, represent a higher priority.*" R2835 (emphasis added).

NYCT continues the process of taking control of the income of approximately a third of designated beneficiaries. At its next meeting (July 1971) the Distribution Committee voted to discontinue automatic payments to ten designated beneficiaries and to continue payments to about 50 others. R2879-83. It also voted -- without any apparent basis in the R&D -- "to give the [NYCT] director discretion to suspend automatic payments to the eight designated payees of the . . . Bonynge Fund [one of which was CSS] if, *in his opinion, a more useful purpose* would be served by making larger grants to one or more of the designated agencies." R2881 (emphasis added).

The docket memorandum for the July meeting had only one short entry regarding CSS:

> In view of the change of direction of [CSS], the Committee voted to suspend six designated payments to this organization but requested the director to work closely with the organization so that the Committee would have the opportunity to fund specific projects of [CSS] if they seemed desirable and necessary.

R2856. As this entry makes clear, by July, the NYCT staff had decided to treat the Distribution Committee's expressly temporary suspension in March as though it had been final. Moreover, the suggestion that CSS might still receive funds for projects NYCT believed "desirable" and "necessary" reflects a further disregard of the command of the R&D that the donor's designation be honored unless payment is found to be *un*necessary or *un*desirable.

The variance power is formally exercised as to CSS. Over the summer of 1971, preparations for further exercises of the variance power proceeded on a second front: a so-called analysis of donor intent.[12/] Ms. Grants testified at trial that she reviewed NYCT internal files pertaining to various designated funds, including the six trusts, and prepared memoranda summarizing this research for inclusion in the September 1971 docket memorandum. *See* R2314, 2341, 2401-02. As Ms. Grants admitted, nothing in NYCT's files suggested that any donor would have wanted funds diverted from CSS simply because CSS made changes to its program such as those proposed by the Study Committee Report (*see* discussion at R3928-3936), and the reports on her research made no such claim (*see* R2886-88; R2891; R2894; R2895; R2896; R2897-99). Despite this dearth of support, NYCT's staff recommended to the Distribution Committee that it exercise the variance power as to CSS for each of the six trusts (as well as a seventh trust, the Prince Trust). R2907-2923.

On September 17, 1971, in the course of an hour and twenty minute meeting, which included lunch and other time consuming business (including approval of a large grant to CSS), the Distribution Committee exercised the variance power as to nine beneficiaries. R2933-37; R2241 (Wainwright). In addition to CSS, NYCT that day found it "undesirable" to continue payments to the NAACP, The Federation of Jewish Philanthropies, Catholic Charities of the Archdiocese of New York, The Salvation Army, The United Hospital Fund, and The *New York Times* Neediest Cases Fund. R2907-17; R2934-35. The record of the

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12/ Notwithstanding NYCT's current position that analysis of donors' intent is improper. App. Br. 3 (Question 3), 24.

meeting contains no adverse information regarding any of these charities or their work, and no indication that they did not need the money or would not use it wisely.

Any suggestion that the variance exercise as to CSS turned on the wording of particular trust instruments (such as the Williams Trust reference to material relief of poverty) is rebutted by the fact that the Committee simultaneously varied all the trusts, including the two Frank Trusts and the Rockefeller Trust, each of which made unrestricted designations of money to CSS. R48-49; R2623; R2627.

NYCT confirms its high regard for CSS and its work by giving it back the money it just had taken. In the very meeting at which it voted to cut off CSS's trust income, NYCT made a $180,000 grant to CSS for its Jose de Diego-Beekman Houses project. R2934; R2945-46. This project was part of CSS's "new directions" approach of assisting the community in its own self-improvement efforts -- in this case by helping organize "day care, programs for the aged, recreation and health programs" in a housing complex in the Mott Haven section of the South Bronx. R2013 (Emerson); R2931-32. Apparently seeing no contradiction of its finding earlier the same day that paying money to CSS from the trusts at issue was "undesirable," the Committee funded the grant by paying CSS its income share from every single one of the varied trust funds. R2934; R2945.

CSS receives no notice of termination. At its September meeting, the Committee also decided to send a letter in the following form to each terminated beneficiary:

> The Committee has conducted a review of the [name] Fund and has concluded that, in view of the substantial change of circumstances since the Fund was established [] years ago, the grant program on [sic] the Fund should be revised. . . . The enclosed check, therefore, represents the terminal payment under the old grant procedure.

R2936; R2947. CSS was never sent this letter. Instead, it received a letter that said *nothing* about variances or "terminal payments[s]," but informed CSS that the Distribution Committee had made it a $180,000 grant. R2945-46. The letter speaks warmly of the ongoing relationship between NYCT and CSS, and praises the very same CSS "new directions" that -- unbeknownst to CSS -- were the supposed basis for NYCT's termination of payments to CSS that same day. *Id.*

Despite NYCT's purported exercise of the variance power, a special relationship between NYCT and CSS arising out of the six trusts continued. As NYCT conceded at trial, after September 1971 it continued to fund CSS projects with at least five figure sums each year through 1986. R2162-66 (Slutsky); R3813-14.[13/] NYCT also put CSS in a special preferred category for future grants (meaning that CSS's grant applications were given priority over all others) (R2451, 2494-96 (Grants)), and referred to this special status in subsequent communications with CSS (R3318). By putting CSS in a "special category," NYCT both confirmed that CSS was not an undesirable fund recipient, and acknowledged that the trust relationship created by the donors had not been repudiated. *See infra*, at 48-50.

NYCT covers up and then reverses its decision to exercise the variance power with regard to the Prince Trust. In a letter dated March 25, 1972, Dr. Saul Scheidlinger, in whose honor the grant to CSS under the Prince Trust was made, wrote to NYCT, asking what payments from the Prince Trust, if any, had been made to CSS. R3037. Mr. Payson quickly responded to Dr. Scheidlinger, listing the distributions of Prince Trust income to CSS for the years 1964 to 1971. R3038. Mr. Payson did not disclose that in 1971 the variance power

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[13/] As discussed in more detail at 49-50, *infra*, the grant statistics in NYCT's brief to this Court (App. Br. 31) exclude substantial post-1971 payments from NYCT attributed to trusts other than the six at issue.

had been exercised as to the Prince Trust's designation of CSS, saying only that, based on the Trust's portfolio, "we anticipate that this year's grant to [CSS] will be slightly smaller than last year." *Id.*

Having been caught by the nephew of a donor, NYCT immediately reversed its exercise of the variance power with regard to the Prince Trust without ever disclosing its conduct either to CSS or Dr. Scheidlinger. R3038; R3051. NYCT's willingness to reinstate CSS so quickly demonstrated again that NYCT did not truly believe that payments to CSS were undesirable, and served to obscure further the record as to whether there had been a complete repudiation of NYCT's fiduciary relationship with CSS.

CSS discovers the history of the six trusts. On June 18, 1993 (after several leadership changes had taken place at CSS since the exercise of the variance power, *see supra*, at 8, 9 n.7), CSS received an advice from Chemical Bank showing a transfer to CSS from the Williams Trust. R1949 (Jones); R3155. An internal investigation ensued, which disclosed CSS's trust relationship with NYCT. R1960-62 (Jones). This proceeding followed.

ARGUMENT

I. NYCT ABUSED ITS DISCRETION IN VARYING THE CSS TRUSTS.

A. The Standard of Review

The Surrogate held, and the parties agree, that NYCT's exercise of the variance power as to CSS is subject to judicial review for abuse of discretion by the Distribution Committee. R17(11-12); App. Br. 20; *accord* R3134-35 (1993 opinion of NYCT's counsel). As the Surrogate correctly noted, the standard of review here "parallels the scope of review of a trustee's exercise of discretion," and, "[u]nder that body of law . . . [a] fiduciary abuses his discretion by acting dishonestly or with improper motive, by failing to use his or her

judgment, or by acting beyond the bounds of a reasonable judgment." R17(11-12).[14/] As the Surrogate further held, a trustee also abuses his discretion where he "misconstrues the scope of his authority and applies the incorrect standard." R17(15) (citing *Stillman*, 107 Misc. 2d 102, 433 N.Y.S.2d 701; *Matter of Kaminester*, 16 Misc. 2d 1071, 184 N.Y.S.2d 237 (Sur. Ct. Kings County 1959)).

The Community Foundations' proposed brief *amicus curiae* suggests that "[a]bsent compelling evidence of bad faith, no court should review an exercise of the variance power by a distribution committee." Community Founds. Br. 23. We do not believe even NYCT supports this truncated standard of judicial review, and there is no case support for the proposition, at least where the trust instrument specifies a standard of conduct for the exercise of fiduciary duty as the R&D does here. *See, e.g., In re Van Zandt's Will*, 231 A.D. 381, 384, 247 N.Y.S. 441, 445 (4th Dep't 1931) (even when will left amount of beneficiary's disbursement subject to discretion of executors, it was "not an arbitrary discretion" and executors "cannot shut their eyes to [the beneficiary's] needs"); *Estate of Mayer*, 176 Misc. 2d 562, 565, 672 N.Y.S.2d 998, 1000-01 (Sur. Ct. New York County 1998); *Conway* v. *Emeny*, 96 A.2d 221, 225 (Conn. 1953) (where "testatrix established a standard to guide the trustees and to limit their action . . . . The failure of the trustees to apply the standard . . . in reaching their decision . . . was a violation of their duty"). Tellingly, the Community

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[14/] *Citing Matter of Stillman*, 107 Misc. 2d 102, 433 N.Y.S.2d 701 (Sur. Ct. New York County 1980) (*citing Restatement [Second] of Trusts* § 187); *Matter of Lyons*, 20 Misc. 2d 717, 192 N.Y.S.2d 98 (Sur. Ct. New York County 1959), *appeal dismissed*, 10 A.D.2d 571, 100 N.Y.S.2d 313 (1st Dep't 1960); *Matter of Emmons*, 165 Misc. 192, 300 N.Y.S. 580 (Sup. Ct. Broome County 1937); *Manning* v. *Sheehan*, 75 Misc. 374, 133 N.Y.S. 1006 (Sup. Ct. Monroe County 1911); *see also* George Bogert, *The Law of Trusts and Trustees* § 560 at 195 (Rev. 2d ed. 1980) ("[I]f the trustee has gone through the formality of using his discretion but has not deliberately considered the arguments pro and con, and thus has made a decision for no reason at all, his conduct can be characterized as arbitrary and capricious, as amounting to a failure to use his discretion . . . .").

Foundations' *amicus* brief cites no trust law precedent to support its claim, instead relying on a melange of contract, corporate, governmental and condominium law cases to support its novel pronouncement. Community Founds. Br. 24-25.[15]

Applying well-settled principles of trust law instead of this unsupported view, the Surrogate correctly found that NYCT's decision to exercise the variance power as to CSS was an abuse of discretion. The Surrogate based this conclusion on an extensive analysis of numerous documents in evidence and an assessment of live testimony by key witnesses given over the course of a five-day trial. As such, the Surrogate's decision is entitled to "great deference."[16]

B. NYCT's Decision To Cut Off CSS's Trust Income Was "Beyond the Bounds of Reasonable Judgment."

The contemporaneous documentary evidence, the testimony of the 1971 Distribution Committee Chairman, and NYCT's own retrospective analysis of the events of 1971 refer to only two reasons for NYCT's decision that continued payments to CSS were undesirable: (i) that CSS changed its direction in 1971 to eliminate direct relief and casework and (ii) that

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[15] The clear contrast between two entirely separate powers granted by the R&D further confirms that exercise of the variance power is limited by an articulated (and therefore reviewable) standard. While exercise of the variance power depends upon the Committee finding that a change of circumstances renders continued payment "unnecessary, undesirable, impractical or impossible," the Committee is empowered by the R&D to disburse undesignated funds and funds already varied "without regard to and free from any specific restriction, limitation or direction contained in [the trust] instrument." R60-61. *Amicus* Council on Foundations misleadingly conflates these distinct standards in an apparent effort to suggest that the variance power itself is subject to the less restrictive standard. Council Founds. Br. 12.

[16] Where a "court's determination [is] reached after a hearing where essential credibility determinations were made [such determination is] entitled to great deference upon appellate review." *Matter of Dagani*, 226 A.D.2d 197, 199-200, 640 N.Y.S.2d 537, 539 (1st Dep't 1996); *see also Richstone* v. *Q-Med, Inc.*, 186 A.D.2d 354, 354, 588 N.Y.S.2d 772, 772 (1st Dep't 1992) ("Upon review of a bench trial, the findings of fact should be viewed in a light most favorable to sustain the judgment, due deference should be accorded Trial Term in matters of credibility, and the findings of fact should not be disturbed unless such determination could not have been reached under any fair interpretation of the evidence.").

increased governmental assistance to the poor rendered direct relief for private charities unnecessary. *See, e.g.*, R2922; R3079-80; R3429 (Parsons). As shown hereafter, the Surrogate correctly found that neither of these rationales could possibly have rendered further payments to CSS "undesirable," and, therefore, neither provided a reasonable basis for exercising the variance power.

In an effort to buttress the Distribution Committee's 1971 decision, NYCT now implies that the Committee also relied on three other grounds in exercising the variance power: uncertainty about CSS's future plans, financial problems and labor unrest. App. Br. 21-22. The evidence establishes that these three rationales were not considered by the Distribution Committee. In any event, they also do not provide -- separately or cumulatively -- a reasonable basis for exercising the variance power.

1. *CSS's "New Directions"*

In 1971 NYCT relied mainly on CSS's supposed plans to eliminate direct relief to poor people and individual casework as the basis for exercising its variance power. *See* R2278-80 (Grants); R3397, 3429 (Parsons). As was shown at trial, however, CSS did not end -- and did not plan to end -- either direct relief or casework in 1971. As was also shown, accurate information on this subject was readily available to NYCT in 1971. In short, NYCT's erroneous conclusions regarding CSS's program were not reasonable mistakes or interpretations within a range of plausible alternatives. They were simply and inexcusably wrong.

The central point of CSS's Study Committee Report -- and the point that Dr. Emerson described as a "Copernican revolution" -- was that the delivery of traditional social work services should occur in the community, rather than by requiring those needing

help to go to high-rise office buildings where social workers kept regular hours and conducted office interviews with poor people. *See* R2002-03 (Emerson).[17] The Report carefully explains, however, that CSS's new directions mean "we shall continue to give direct service; but it also means a re-thinking of the way in which that direct service is offered." R2788-89; *see also* R2001-03 (Emerson).

NYCT now concedes that CSS did not in fact eliminate direct relief programs in 1971. At trial -- in order to forestall CSS offering further evidence on the subject -- NYCT's counsel stated: "I reread the [Study Committee Report] on which [CSS] had based their change of direction in 1971 and I . . . agree that [CSS] did provide continued direct service of some kind [since the 1960's]." R1983. That NYCT's counsel was able to conclude, simply by reading the Study Committee Report, that CSS was not eliminating direct service proves that NYCT easily could have done the same in 1971.[18]

Nor were further details of CSS's continuing direct relief programs difficult to ascertain. For example, CSS's annual report for 1970-71 described several substantial direct relief programs. R2011-14 (Emerson); R2957-64. Similarly, CSS was prominently featured as a recipient of distributions from *The New York Times* Neediest Cases Fund during 1970, 1971 and 1972 (as it has continued to be to this date). R1916 (Jones); R3327-32. Since the *Times* Fund requires recipient charities to use the monies only for direct relief (R1917-18

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[17] Although NYCT now argues that CSS's intent to "serve 'sick communities'" and "'share power' with 'community groups'" (App. Br. 14 (quoting Study Committee Report)) was a reasonable basis for exercising the variance power, on the very same day it varied the six trusts, NYCT awarded CSS a large grant "[i]n support of [the] promising partnership between the voluntary sector [*i.e.*, CSS] and the community." R2932.

[18] In fact, NYCT was not wholly ignorant of CSS's direct service work in 1971. For example, on cross-examination, Ms. Grants conceded that she understood in 1971 that CSS was still planning to continue providing direct relief, at least with respect to its programs for the aged. R2449. And the de Diego-Beekman grant application specifically proposed funding for caseworkers -- another form of direct relief. R2842.

(Jones)), this publicity also provided easily available evidence that CSS continued to provide direct service, as did an article in *The Social Service Review* of June 1971, which stated that CSS "will not discontinue all family casework and individual counseling" (R2849-50). This information would have been available to NYCT -- as it had been to the author of the June 1971 article -- by simple telephone inquiries or in meetings with CSS. Unfortunately, neither Ms. Grants nor anyone else at NYCT asked CSS the straightforward question of whether it had stopped providing direct relief for poor persons. *See* R2453-54 (Grants).[19/]

In the face of all this evidence on direct service, NYCT shifts grounds, arguing that the "crux of the issue" was that "CSS offered no assurance that distributions of funds from the six subject trusts . . . would be properly applied for the charitable purposes the donor wished." App. Br. 17. As support for this argument, NYCT cites nothing except three pages of the testimony of Mr. Parsons (R3467, 3473-74), none of which bears on the point. More fundamentally, assuring itself that trust monies were being "properly applied" was NYCT's regular ongoing job, not some unnecessary burden it could shed by terminating beneficiaries' rights. If NYCT had really wanted "assurances" that CSS was continuing to provide direct relief and engage in casework (or about any other aspect of CSS's work), it needed only to ask. Indeed, such inquiries would have prevented NYCT from violating the standard it had set for itself for reviewing these Trusts: that after a temporary suspension,

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[19/] In any event, NYCT has never explained why the issue of "direct relief," "material relief" or "direct service" is relevant to those trusts that provided that income should be paid to CSS for its general purposes (*e.g.*, the Rockefeller Trust and the Frank Trusts). For those trusts, there was no "material relief" limitation, and to the extent that the Study Committee Report signaled an intended increase in advocacy, lobbying and community work, this would not have rendered CSS's program inconsistent with the intent of the donors, determinable from the trust instruments or other available sources. Indeed, Dr. Emerson testified that the community orientation of the proposed changes was bringing CSS's approach back to what it had been in the donors' time. R2044 (Emerson); *see also* R1909-10 (Jones); R2439-40 (Grants).

the suspended organization was to "be given ample opportunity to submit further evidence for continuance." R2737. In fact, none of these obvious inquiries was ever made (*see* R2453-55 (Grants)), nor was CSS ever candidly told that its rights were going to be terminated because it supposedly was ceasing direct service or because its new program created uncertainty (*see* R2026-28, 2062 (Emerson)).[20/] Surely a fiduciary terminating or altering rights of a beneficiary cannot blame the *cestui que* trust for failing to give assurances not sought or for failing to guess what facts the fiduciary may have misunderstood or misapprehended.

Instead of disputing the easy availability of all this contrary evidence, NYCT argues that it had a reasonable basis for believing that CSS had ceased to provide direct relief simply because of a CSS "announcement" in a *New York Times* article "that it would discontinue its traditional work of providing services to individuals." App. Br. 14. This argument misstates the facts established at trial. First, the *New York Times* piece is a news article, *not* a CSS "announcement." Second, as shown above, the article's assertion that CSS's "new directions" would result in an elimination of casework was simply -- and ascertainably -- wrong. *See supra*, at 23-24. Given its ready access to CSS staff and to the Study Committee Report itself, NYCT's reliance on a hearsay news article as the basis for making a permanent decision of grave importance to the *cestui que* trust was wholly unreasonable.

[20/] The gravity of NYCT staff's failure to investigate fully CSS's program is underscored by Mr. Parson's testimony that "had I been told that CSS was continuing [one-on-one] work, I would have felt differently about suspending the payments [to CSS], yes." R3434.

Finally, despite having seized upon CSS's self-evaluation and change in approach as its principal basis for finding continued payments "undesirable," NYCT actually regarded the changes favorably. Thus, Ms. Grants -- the only person at NYCT who appears to have read the Study Committee Report -- recommended that NYCT continue to support CSS "based on its excellent program and projects." R2822. Furthermore, when Mr. Parsons was asked if Mr. West had been critical of CSS's new community-based approach he responded, "I am sure he was not." R3429. And of course NYCT continued to support CSS's programs -- including its "new directions" -- beginning on the very day it exercised its variance power. In short, although it is undisputed that CSS was changing some of its programs, the evidence overwhelmingly established that CSS's new directions did not provide a reasonable basis for variance. As the Surrogate correctly held, the mere existence of uncertainty engendered by the prospect of change is not evidence that the change is undesirable -- and unless that crucial link was made, the requirements of the R&D were not met, and it was an abuse of direction to terminate CSS's rights. R17(12-13).

2. *Increased Governmental Aid to the Poor*

The only other reason contemporaneously stated as a basis for exercise of the variance power was that increased government welfare spending had supposedly rendered assistance to the poor by private charities obsolete. *See, e.g.*, R2898; R2907-08; R3429 (Parsons). The Surrogate correctly rejected this argument. R17(14). Even apart from the obvious inconsistency of cutting off CSS both because it was changing its approach and because the old approach was "outmoded," it was simply not true in 1971 that the problem of urban poverty had been solved by government intervention or that the need for CSS's services had declined. R1929-30 (Jones); R2474 (Grants). NYCT offered no evidence at

trial that the need for CSS's services had lessened in 1971, and its substantial grants to CSS in 1971 and succeeding years to support CSS's anti-poverty work contradict any such suggestion. Indeed, the entire point of the CSS Study Committee Report was that existing programs and approaches were not doing enough to attack the persistent problems of poverty in New York City. R1996-97 (Emerson); *see also* R3075 (Mr. West makes the unsurprising observation that government intervention has not solved the problem of urban poverty and that private charitable aid was badly needed. Mr. West does not suggest in any way that this 1975 observation resulted from a recent revelation.).

3. *Three Late Starters*

Apparently dissatisfied with the persuasive value of its contemporaneous reasons for variance, NYCT suggests three additional reasons why the Distribution Committee did not abuse its discretion by deciding to divert income from CSS. None of the three was included in the discussions of the six trusts that appeared in the September 1971 docket memorandum, which was generally the only document that went to the Distribution Committee in advance of meetings. R2907-23; R2481-82 (Grants). Nor was any of these three reasons mentioned in the minutes of the September 1971 meeting at which the variance decision was made. R2933-37; R2482-83 (Grants). And none was mentioned in the memoranda prepared by Ms. Grants in the summer of 1971 and used by the staff to prepare the September docket memorandum. *See* R2886-88; R2891; R2894; R2895; R2896; R2897-99. Moreover, the Chairman of the Distribution Committee testified that the CSS trusts were varied because of CSS's change in direction, ceasing direct relief of poverty, and the increases in governmental assistance to the poor. R3471 (Parsons). It is thus wholly implausible that

any of these three proffered reasons influenced in any material way the Distribution Committee's decision to exercise the variance power as to CSS.

In assessing whether an abuse of discretion has occurred, only those matters on which the fiduciary focused -- and could therefore have applied discretion -- are properly before the Court. *Post hoc* rationales, even persuasive ones (as these are not), may not be considered because they were not the bases for an exercise of judgment at the time and thus cannot satisfy the requirement that the trustee apply its judgment and discretion in reaching a decision. *See supra*, at 20 n.14. *Cf. New York State Chapter, Inc.* v. *New York State Thruway Auth.*, 88 N.Y.2d 56, 75, 666 N.E.2d 185, 193, 643 N.Y.S.2d 480, 488 (1996) (*post hoc* rationalization for agency's adoption of labor agreement cannot substitute for showing that, prior to deciding in favor of agreement, agency considered goals of competitive bidding). In any event, none of these reasons provides a reasonable basis for variance.

1. *Uncertainty about future plans*. According to NYCT, uncertainty about CSS's future plans was a "stated ground" for exercising the variance power. App. Br. 21. Even if true, this does not answer the critical question: *why should temporary uncertainty ever justify permanent avoidance of gifts given in perpetuity*? As the Surrogate found, it was utterly illogical that the Committee's short term uncertainty about the details of a new program (the broad outline of which they regarded highly) could be a fair basis for cutting off funds from CSS *forever*. *See* R17(12-14); *see also* further discussion *infra*, at 34.

In any event, some uncertainty and lack of specificity was appropriate, because, as Dr. Emerson testified, the Report was "the general map" of where CSS's program was headed and a statement of "the general philosophy under which we were going to operate." R2003-04. Moreover, despite the fact that the Report itself is about concepts and not details,

many of the specifics of CSS's program change had been worked out by the time the Report was issued in January 1971. R2046 (Emerson). For instance, planning for the de Diego-Beekman Houses project, which "was a perfect example" of what CSS wanted to do as set out in the Study Committee Report, had begun in December 1970. R2023-24 (Emerson). Also, many of the services CSS had in place prior to the release of the Study Committee Report were to be continued. R2005-06 (Emerson).

2. *CSS's financial problems*. NYCT argues that the fact that CSS was running a deficit in 1971 was another "basis" for exercising the variance power. *See* App. Br. 22. There is no evidence whatsoever that CSS was -- or was thought to be -- profligate or inefficient. And as Ms. Grants conceded, the fact that CSS was running a deficit meant there was not much question that CSS "needed money." R2415.[21/] As the Surrogate found, CSS's deficit could not, therefore, provide a rational basis to cut off distributions to CSS. R17(14).

3. *Labor unrest at CSS*. Apparently relying on an internal NYCT staff memorandum written by Mr. Payson dated June 21, 1971 (which does not include any members of the Distribution Committee on its routing list (R2838)), NYCT suggests that the unionization of CSS's caseworkers in 1971 was yet another "stated ground" for exercising the variance power. App. Br. 21. There is no evidence that this was considered by -- or even brought to the attention of -- the Distribution Committee (nor is it explained how the supposed concern can be reconciled with NYCT's professed belief that CSS was eliminating casework). In fact, there is no indication that anyone at NYCT was particularly concerned

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[21/] At trial NYCT also suggested that the variance decision was based on CSS's large endowment. *See* R2302, 2304 (Grants). Perhaps realizing that this contradicts its argument that it exercised the variance power because CSS was running a deficit, NYCT has dropped the endowment ground on appeal.

about labor issues. The one reference to unionization in the documents, the Payson memorandum, merely notes that unionization was delaying CSS's implementation of its new program; it does not indicate that NYCT was at all troubled by this delay. R2838. NYCT presented no evidence to show that CSS's program was hampered by unionization, let alone hampered in a sufficiently permanent way to justify departing from the donors' intent by cutting off distributions to CSS forever. The Surrogate was therefore correct in finding that this supposed concern could not support an exercise of the variance power. R17(14).

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In sum, neither the two reasons for variance documented contemporaneously, nor the additional reasons suggested in hindsight (none of which came before the Distribution Committee at the time), nor any combination of these competing and contradictory approaches, provided a reasonable basis for the exercise of the variance power.

C. NYCT Failed To Bring Judgment To Bear on Its Decision To Vary the Six Trusts.

As the Surrogate correctly held, a fiduciary such as the NYCT Distribution Committee abuses its discretion if its fails to bring judgment to bear on the issue to be decided. R17(11-12). As discussed below, this is precisely what happened when the Distribution Committee drifted without serious analysis from a temporary suspension of CSS to its permanent termination.

Following the "temporary" suspension of CSS based on an erroneous *New York Times* article, the only information relating to the variance of CSS funds presented to the Committee (apart from highly favorable information in support of the de Diego-Beekman grant (*see* R2931-32)), consisted of a docket memorandum summarizing Ms. Grants's

review of NYCT's internal files (R2907-23). Contrary to NYCT's claim that this memorandum was "detailed" (App. Br. 15), it did not include any information regarding CSS's new program (or, for that matter, CSS). Moreover, NYCT's assertion that "NYCT's staff thoroughly reviewed and analyzed the Study Report and the trust instruments or wills establishing the six funds at issue" (App. Br. at 15) is inaccurate and misleading. Only Ms. Grants appears to have read CSS's Study Committee Report, and, after doing so, she recommended that payments to CSS *continue*. *See supra*, at 13. There is no evidence that any Distribution Committee member saw either CSS's Study Committee Report (Parsons said he did not (R3433)) or Ms. Grants's internal memoranda analyzing that Report (which in any event supported continued payment to CSS) (R2822-24; R2281 (Grants)).

The extensive documentary evidence from 1971 also shows that CSS and its program were *never* substantively discussed by the Distribution Committee after the release of the Report. There were four potentially relevant Distribution Committee meetings: March, May, July and September. The only mention of CSS in the March docket memorandum and minutes is a notation that CSS was being *temporarily* deferred pending future analysis of CSS's program. R2817; R2820. CSS is not mentioned at all in the May docket memorandum or minutes. R2826-32; R2833-36; *accord*, R2390 (Grants). And although the July docket memorandum (written by the staff before the meeting (R2480-81 (Grants))) refers to the Distribution Committee's March decision based on the *New York Times* article (R2397-98 (Grants); R2856), CSS is not mentioned at all in the July minutes (R2878-84).

The September docket memorandum mentions CSS in connection with each of the designated trusts that named CSS as a beneficiary, but none of these references include substantive information about CSS or its program. R2907-23. The only substantive

discussion of CSS in the whole September docket is the favorable memorandum presented in support of the de Diego-Beekman project. R2931-32.[22]

Nor is it at all likely that the staff presented to the Distribution Committee orally any analysis of CSS or its program not reflected in the minutes or dockets. As Ms. Grants testified, the normal practice at NYCT was for Mr. West to make oral presentations in which he capsulized what was in the docket memorandum. R2386-88. Because there was nothing in the March, May, July or September docket memoranda regarding CSS's program, there was nothing for Mr. West to "capsulize."[23] Moreover, the meetings in question were all quite short, ranging from an hour and ten minutes to an hour and forty-five minutes, including lunch (R2242-43, 2246-47 (Wainwright); R2389-90 (Grants); R2819, 2821; R2833, 2836; R2878, 2884; R2933, 2937), and the agendas all were quite full (*see* R2384-89 (Grants)). The September lunch meeting, at which the variance power was exercised as to CSS and eight other charities, and which included consideration of substantial other business, lasted only an hour and twenty minutes. R2933-37.

All these facts powerfully contradict NYCT's unsupported assertion that the Distribution Committee engaged in "extensive deliberations" about CSS. App. Br. 17.

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[22] NYCT's claim that the memoranda attached to the September docket memorandum "analyzed" both "CSS's decision essentially to terminate its prior casework services" and "CSS's proposed community action work" (App. Br. 16) is wrong. For three of the trusts (Rockefeller and both Frank Trusts), the corresponding memorandum simply states that CSS had been suspended "pending staff analysis." R2907-09, 2914-15. The only mention of CSS in the Adler Trust memorandum is the statement that CSS was a designated beneficiary of that Trust. R2912-13. The "analysis" of CSS's program in the Williams Trust memorandum (incorporated by reference in the Griffith memorandum) consists solely of the erroneous statement that CSS "has discontinued case-work services." R2922-23. None of the six memoranda says anything at all about "community action work." And none presents any reasonable basis for concluding that continued payments to CSS was "undesirable."

[23] Although on re-cross-examination Ms. Grants claimed to be "certain" that CSS was discussed in May (R2497), she earlier testified that she did "not recall specifically" that there was any such discussion (R2400), thus confirming the inference to be drawn from the absence of a docket or minute entry.

Insofar as CSS and its programs were concerned, the Committee's decision to vary the six trusts started and ended with an erroneous article in the *New York Times*. This failure to bring any judgment to bear upon the question of whether "circumstances ha[d] so changed . . . as to render . . . undesirable . . . a literal compliance with the terms of [the six trust instruments at issue]" was itself an abuse of discretion.

D. The Surrogate Did Not Substitute Her Own Judgment for That of the Distribution Committee.

NYCT argues that because the Surrogate acknowledged that the Distribution Committee had identified specific changes in circumstances (CSS's new directions, the Great Society, labor unrest, etc.), her conclusion that the Committee abused its discretion must have been the result of a substitution of her judgment for that of the Committee. App. Br. 21-22. This is wrong. The Surrogate found that the Distribution Committee abused its discretion because it failed to address the question of whether the identified changes made further payments to CSS undesirable. R17(13-14). She further found that there was no reasonable basis for concluding that the identified changes made further payments undesirable and that the Distribution Committee's decision, if exercised on that basis, went beyond the bounds of reason. *Id.* None of this substituted the Surrogate's judgment for that of the Distribution Committee, but simply reflected her conclusion that the Committee had not exercised its judgment nor correctly applied the standards set out in the R&D. *See Van Zandt's Will*, 231 A.D. at 384, 247 N.Y.S. at 445 ("Where a trustee has been given freedom to act according to his own judgment in matters pertaining to another, and he fails, in the opinion of the court, to exercise such discretion in a proper manner, he may be compelled to do that which the trust fairly requires him to do."); *Manning*, 75 Misc. at 377, 133 N.Y.S.

at 1008 ("There can be no doubt of the power of this court to compel the trustee to exercise in a reasonable manner the discretion invested in him by the will. That does not substitute the judgment of the court for the judgment of the trustee, when honestly exercised . . . .").

The Surrogate's observation that "[c]hange is inevitable" (R17(12)), which NYCT characterizes as a "personal view" (App. Br. 22), is not only obviously true, it is -- as NYCT's *amici* elsewhere trumpet -- the fundamental principle on which the concept of community foundations is based. *See, e.g.*, Community Founds. Br. at 7, 10 (citing Richard W. Pogue, *The Cleveland Foundation at Seventy-Five -- An Evolving Community Resource* (1989), at 10-11). And the conclusion that change is not in and of itself a basis for exercise of the variance power is plain on the face of the R&D. It follows, then, that because both the R&D and the law of trusts requires that reason be brought to bear on the question of whether the identified changes were undesirable, the Surrogate was correct that "parroting the language of the Resolution" is insufficient. R17(11).

The record evidence in fact shows that the Surrogate was more faithful to the R&D than was NYCT. For example, rather than determining whether changed circumstances made continued payments to CSS under the instruments undesirable (or unnecessary, impractical or impossible), the Distribution Committee acted on the erroneous assumption that it was enough to find that times had changed and that NYCT had "more desirable" or "higher priority" uses for the money than to distribute it as directed by the donor. Thus, when pressed to identify which of the four standards the Distribution Committee had relied upon when it cut off funds to CSS, Ms. Grants affirmed at trial her deposition testimony that "I do not believe that that was a subject of discussion to that degree, other than that the conditions had so changed *that it was more desirable to do something else*." R2435-36

(emphasis added); *see also* R2456-57 (Grants). The erroneous notion that the variance power may be exercised because the Committee finds other charitable purposes more desirable runs through the documents as well, also supporting the conclusion that the Committee did not adhere to the R&D. *E.g.*, R3083 ("Committee decided that it was no longer *necessary or desirable* to continue a literal compliance with the founding instrument") (emphasis added); R2881 (West given discretion to suspend Bonynge payments "if, in his opinion, a *more useful* purpose would be served by making larger grants" to fewer of the designees) (emphasis added); R2835 (Bailey Fund income to be allocated to "projects which, in the opinion of the Committee, represent a *higher priority*") (emphasis added).[24] Such a departure from standards, by itself, is a sufficient basis to abrogate the Distribution Committee's decision. *See Conway*, 96 A.2d at 224-25; *Kaminester*, 16 Misc. 2d at 1072, 184 N.Y.S.2d at 239-40.[25]

These obvious misstatements of the requirement that, under the R&D, continued payment must be found *un*desirable (rather than that some other use of the money be more desirable in the eyes of the Distribution Committee) continue to this day -- perhaps born of confidence that the eminent members of the Distribution Committee know better than donors how to allocate the donors' charitable monies. Thus, the papers submitted by NYCT's *amici* repeatedly misstate the scope of discretion given to the Distribution

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[24] *See also* R2830 (trust money to go to "organizations having *greater need*" than those designated by the donor) (emphasis added); R2855 (gift "unnecessary and undesirable in view of the urgent needs of others"); R2917 ("annual grant . . . can be made *more effective* by discontinuing this grant [to the *New York Times* Neediest Cases Fund] and making it a semi-designated fund for health and welfare in New York City") (emphasis added).

[25] As NYCT's own witnesses conceded, application of a "more desirable" standard would be an improper departure from NYCT's governing instrument. R2189 (Slutsky); R2240 (Wainwright).

Committee of NYCT, apparently confusing it with the aspirations of Mr. Frederick Goff or the language of other foundation instruments that are less limiting. For example, the affidavit of Malvin E. Bank, counsel to the *amicus*, the Community Foundations, erroneously describes the variance power as authorizing a foundation "to redirect income from a designated charitable fund where necessary or desirable to meet the changing charitable needs of the community." Affidavit of Malvin E. Bank, sworn to January 28, 2000, ¶2. Mr. Bank, who practices law in Cleveland, also shares with this Court the original variance language of the Cleveland Foundation, which is plainly less restrictive than New York's, and may be the source of his confusion. Community Founds. Br. 14. Both *amici* briefs persist in these errors, citing to the philosophy of Mr. Goff as though it had somehow attained the force of law.[26/]

In addition, the wide range of contradictory reasons simultaneously asserted by NYCT for exercising the variance power as to dozens of beneficiaries of the highest reputation devoting their efforts to causes of unquestionable value confirms that NYCT simply was looking for colorable reasons to remove designations. Among these excuses were that the grant was small compared to the size of the endowment of the beneficiary (R2828; R2834); the beneficiary's endowment was too large (R2816; R2834); the gift was too small or "insignificant" (R2829; R2834; R2881); or the gift had been given to the

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[26/] *E.g.*, Community Founds. Br. 18 (endorsing Mr. Goff's view that foundation is "to determine what should be done [with gift] to make it most useful for people of each succeeding generation" but making no mention of the donor). *See also id.* at 5 (Committee given "full discretion over continuing use of charitable funds"); *id.* at 7 (Committee has "the power to alter income recipients when necessary or desirable to meet the community's changing charitable needs"); Council on Founds. Br. 6 (R&D "furnishes absolute discretion to the Committee to determine how most effectively to accomplish the general purpose of the community foundation"); *id.* at 14 (R&D should be read so that if "change in the population has created a new social ill or crisis" NYCT will have the "flexibility . . . to tackle these complex problems").

beneficiary for a long time (R2857). Significantly, Mr. Parsons, a Senior Partner in the law firm of Milbank, Tweed, Hadley &McCloy, who was the Distribution Committee Chairman in 1971, and counsel to NYCT from 1952 to 1969, testified that none of these were proper reasons for exercising the variance power. R3458-61.[27/]

II. THE SURROGATE CORRECTLY INTERPRETED AND APPLIED NYCT'S VARIANCE POWER STANDARD.

Because the R&D explicitly requires that to vary a designated trust the Distribution Committee must find both (i) that circumstances have changed, and (ii) that such change renders literal compliance with the terms of the instrument "unnecessary, undesirable, impractical or impossible," any interpretation of the variance power that does not recognize the need to take both analytic steps would expand the power of the Committee beyond the limits set by the trust instrument. R17(11).

To take both these requirements of the R&D into account, the Surrogate held that after a change of circumstance is identified "[t]here must be identifiable negative details to support the determination of undesirability, impracticality, impossibility or lack of necessity which would be likely to cause the donor to withdraw her support." R17(11).[28/] On the facts

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[27/] Although the Surrogate did not agree, CSS also established that NYCT abused its discretion by departing from the particular procedures it created to permit a fair review of designated beneficiaries in 1971. These included the failure to give CSS an "opportunity to submit . . . evidence for continuance" of payments after a temporary suspension. R2737. Former Distribution Committee Chairman Parsons agreed in his testimony that NYCT should have given CSS and others this fundamental opportunity before cutting off their rights. R3456. CSS, however, was never told of its temporary suspension, much less that it could present evidence for continuation. And of course CSS did not know that the undisclosed ground for termination was its much praised "new directions" or some theory that private charitable aid for the poor was now unnecessary.

[28/] NYCT inserts a bracketed clause into the quoted language from the opinion, stating that the Surrogate found that "'there must be identifiable negative details [*about the designated charity*] to support the determination of undesirability, impracticality, impossibility or lack of necessity.'" App. Br. 23 (quoting 17(11)) (emphasis added). This additional bracketed language comes from NYCT -- not the Surrogate -- and inaccurately narrows the Surrogate's holding. *See* R17(11).

of this case, the formulation makes irrefutable good sense: it rejects the proposition that change alone -- such as CSS's new directions -- can justify variance without an analysis of how that change renders continued payment undesirable. R17(12-13). Consistent with this understanding, the Surrogate's central finding is that neither CSS's new program, nor the other identified changes at CSS and in society, were linked by the Distribution Committee to the undesirability of making payments to CSS. R17(13-14).

NYCT criticizes the Surrogate's formula on two grounds: first, that by this articulation "the Surrogate announced a totally new standard for the exercise of the variance power" that "is clearly contrary to the [R&D]"[29] and second, that the Surrogate erred by taking into account donor intent because "[r]equiring a showing that the donor would have wished to redirect funds has no basis in the [R&D]" App. Br. 23-24. Neither criticism is well-founded.

First, the idea that a change in circumstances must negatively affect the desirability of continuing payments to a beneficiary is inherent in the word "undesirable," (as well as "impossible," "impractical" and "unnecessary"). Thus, the supposed changes in CSS's programs were of no moment if they did not support a finding that continued payments to CSS were "undesirable." In this context, the term "negative details" simply means that there must be adverse consequences to continued payments in light of the changed circumstances -- otherwise the changed circumstances will not have been proven undesirable (or

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[29] NYCT states that the Surrogate "undertook to enunciate 'the standard that governs a community foundation's exercise of its variance power.'" App. Br. 23 (quoting R17(9-10)). This partial quote from the Surrogate's opinion leaves the misimpression that the Surrogate professed to be re-writing the variance power. The full sentence, however, makes only the undisputed observation that "[n]o reported decision, in New York or elsewhere, discusses the standard that governs a community foundation's exercise of its variance power." R17(9-10). The Surrogate then went on to "*interpret*[]" the standard, not rewrite it. R17(10) (emphasis added).

impossible, impractical or unnecessary). The critical failure of the Distribution Committee as to CSS was that it identified a supposed change, but showed by its words (*e.g.*, R2931-32; R2945-46) and actions (*e.g.*, R2934) that it regarded the change as positive, not negative. *See also* R17(14). Accordingly, application of the Surrogate's formulation -- like the application of general trust principles -- required a finding that the Committee abused its discretion when it found that these positive changes rendered further payments undesirable.

NYCT's argument that the "Surrogate's standard would vitiate the purpose of the [R&D]" because "exercise of the variance power may be particularly appropriate where a charity fully *succeeds* in achieving its purpose" (App. Br. 23-24) is without merit. It defies reason to suggest that the Surrogate intended to interpret the variance power to prohibit the Distribution Committee from exercising its power if a positive change in circumstances made it unnecessary or undesirable to continue distributions; and in fact, the Surrogate's formulation makes equal sense when applied to favorable developments. For example, in the hypothetical case of trust monies designated for finding a cure for polio, the development of polio vaccines was obviously a positive, not negative, change of circumstances. Equally obviously, however, there would be adverse consequences in continuing to spend charitable money seeking a cure for an eradicated disease. That conclusion is as much a "negative detail" insofar as continued payments are concerned as would be evidence that charitable money was being wasted, diverted or otherwise misused. Indeed, any other interpretation of the variance power would render the second requirement of the R&D meaningless: if circumstances changed but payments to a particular beneficiary would still be valuable (*i.e.*, no "negative details" were uncovered), further payments to the beneficiary would not be "unnecessary, undesirable, impractical or impossible," and it would be wrong for the

Distribution Committee to substitute its judgment for that of the donor by exercising the variance power.

NYCT's second criticism of the Surrogate's interpretation of the variance power is that it takes into account donor intent by requiring that the change must be of such a nature as "'would be likely to prompt a donor of the fund to re-direct [the income].'" App. Br. 24 (quoting R17(11)). This formulation is nothing more than recognition of the plain requirement of New York law that *all* interpretations of trust instruments be undertaken with a view to effectuating donor intent. *E.g.*, *Mercury Bay Boating Club, Inc.* v. *San Diego Yacht Club,* 150 A.D.2d 82, 90, 545 N.Y.S.2d 693, 698 (1st Dep't 1989) ("In interpreting a trust, courts must look to the intent of the settlor as expressed in the trust instrument."), *aff'd*, 76 N.Y.2d 256, 557 N.E.2d 87, 557 N.Y.S.2d 851 (1990). While NYCT now argues that consideration by the Distribution Committee of donor intent has no basis under the R&D, that position is inconsistent with NYCT's own reading of the R&D in 1971 and thereafter. Indeed, the Distribution Committee's guidelines for reviewing designated funds included the following standard -- a standard remarkably similar to the Surrogate's:

> The word "undesirable" will be interpreted in the light of changed conditions, and particularly how current conditions relate to those existing at the time of the donor's request. Conditions may have changed in four respects: a. The focus of operations of the agency itself may have moved *away from the problems which interested the founder*. . . . c. The need for the services may have declined *to the point where the donor would have wished the grants [sic] payments to be discontinued.*

R2817 (emphasis added); *see also* R2820. Moreover, virtually the only analysis that NYCT actually undertook following the temporary suspension of payments to CSS was a review of internal files in an (unsuccessful) effort to determine donor intent. R2314 (Grants); R2886-88; R2891; R2894; R2895. This, of course, is precisely what New York law

requires, as NYCT concedes today by stating that "'th[e] command of the *testator* is the law' that governs trust instruments." App. Br. 25 (quoting *In re Lloyd's Estate*, 292 N.Y. 280, 285, 54 N.E.2d 825, 828 (1944) (emphasis added)).[30/]

III. CSS'S PETITIONS ARE NOT BARRED BY THE STATUTE OF LIMITATIONS.

A. Because NYCT Did Not Clearly and Unequivocally Repudiate CSS's Entire Interest in the Six Trusts, CSS's Claims Are Not Time Barred.

As it did below, NYCT argues that CSS's claims are barred by the statute of limitations because CSS knew that it no longer received *automatic* distributions from the six trusts. App. Br. 26. The Surrogate properly rejected this attempt by NYCT to rewrite well-settled law, holding that in a trust relationship, the statute of limitations does not start to run until the trustee clearly, openly and unequivocally repudiates any and all rights that the beneficiary has in the trust. *In re Estate of Barabash*, 31 N.Y.2d 76, 80, 286 N.E.2d 268, 270, 334 N.Y.S.2d 890, 893 (1972); *In re Estate of Velsor*, 40 Misc. 2d 595, 595, 243 N.Y.S.2d 477, 478 (Sur. Ct. Nassau County 1963); *see also* 106 N.Y. Jur. 2d *Trusts* § 357, at 409 (1993).

Because a trustee has the highest duty of loyalty to beneficiaries, *see Meinhard* v. *Salmon*, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928), beneficiaries should be entitled to

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30/ NYCT argues that "[i]f the donor intended the standard to rest on a change of circumstances that would have motivated him or her to reallocate the monies, the donor would have explicitly said so and would have chosen as a trustee a family member or friend . . . or even a psychologist . . . ." App. Br. 24. There are at least two problems with this argument. First, it reflects NYCT's persistent refusal to recognize that a change in circumstances is not enough; the R&D expressly requires that exercises of the variance power be based on a "change in circumstances" that in the judgment of the Committee renders payments undesirable. Second, the Surrogate's only point was that the variance decision should be made with the intent of the donor in mind. The Surrogate did not find, as NYCT states, that the community foundation must find that the donor "would have . . . reallocate[d] the monies," but, only that the change "would *be likely* to cause the donor to withdraw her support" (R17(11) (emphasis added)) -- the same point made by the Distribution Committee's own guidelines (R2817).

assume that that duty will be performed, and should not be required to scrutinize their fiduciary's conduct so long as they have reason to believe that the fiduciary relationship continues, *cf. Greene v. Greene*, 56 N.Y.2d 86, 94, 436 N.E.2d 496, 500, 451 N.Y.S.2d 46, 50 (1982) (action against a fiduciary, noting that "a person seeking professional assistance has a right to repose confidence in the professional's ability and good faith, *and realistically cannot be expected to question and assess the techniques employed or the manner in which the services are rendered*") (emphasis added). Thus, where a trustee contends that the statute of limitations has run because he has repudiated the trust, "it is essential, in order that he may claim the benefit of the statute, for the trustee to show a clear or plain, strong, and unequivocal renunciation, amounting to an open disavowal of the trust. The disavowal must be made in no uncertain terms and without qualification." 76 Am. Jur. 2d *Trusts* § 716, at 700 (1992); *see also In re Geraerdts' Will*, 211 N.Y.S.2d 915, 917-18 (Sur. Ct. Westchester County 1961) (trustee must show it has denied the existence of the trust and "assert[ed] and exercis[ed] individual ownership of the trust property") (internal quotation marks omitted).[31/]

Guided by this well-settled law, the Surrogate held at the summary judgment stage that for the statute to have begun to run against CSS or any other designated beneficiary of a community trust, there must have been a *complete* repudiation -- not a modification of terms or a limitation of rights, but a repudiation of "any and all right or status whatsoever" of the beneficiary. R526. Moreover, as the Surrogate noted in her June 3, 1998 opinion regarding The Salvation Army (R1652):

[31/] The trustee also has the burden of showing when the statute began to run. *In re Lewin's Estate*, 41 Misc. 2d 72, 75, 245 N.Y.S. 2d 254, 258-59 (Sur. Ct. Suffolk County 1963).

> Satisfying the legal standard for repudiation of a trust is difficult in any case, but it is especially difficult here because NYCT by its nature maintains an unseverable relationship with charities to the extent that they always remain eligible to apply for and receive grants from undesignated funds. Even a mere acknowledgment of such continuing eligibility may mute the message of complete repudiation of designated beneficiary status. It is for this reason that the analysis [is so] exacting . . . .

Following the denial of NYCT's summary judgment motion, there was extensive pretrial discovery on statute of limitations issues. And a substantial part of the trial was then devoted to statute of limitations. After hearing the testimony and reviewing the written evidence, the Surrogate found that the trial record "buttress[ed] the Court's conclusions reached in 1996." R17(16). As the evidence established and the Surrogate found, (i) CSS received no clear notice of variance and (ii) after the variance exercise, NYCT continued to make payments to CSS and to maintain a special, preferential relationship with CSS that was at odds with complete trust repudiation. *Id.* On this basis, the Surrogate reaffirmed the conclusion that "[t]he mixed signals given by the NYCT sufficed to commence the limitations period as to each year but failed to notify CSS that the 1971 action abrogated any special relationship between the NYCT and CSS so that CSS was relegated to the position of any other charity seeking discretionary funds." R17(15). In other words, NYCT's ongoing relationship with CSS "muddied the message of an otherwise clear repudiation, and thus there was no effective repudiation." R17(16).

CSS submits that, at the least, this Court should affirm the Surrogate's holding that NYCT's "mixed signals" never conveyed the message that the trusts were totally repudiated for all time, and, therefore, CSS's claims for the period starting six years prior to when it filed its petitions are not barred. By its cross-appeal, moreover, CSS contends that the notice of repudiation was so inadequate that the statute was never triggered at all, even for the

period more than six years prior to commencement of the litigation. The same facts that show beyond doubt that the Surrogate's narrower ruling was correct support CSS's cross-appeal as well. *See Barabash*, 31 N.Y.2d at 80, 286 N.E.2d at 270, 334 N.Y.S.2d at 893 (reversing Appellate Division's application of statute of limitations because "repudiation by the fiduciary was less than unequivocal").[32/]

NYCT never gave CSS clear notice of variance. Sixteen months before the September 1971 variance vote, CSS received a routine form letter asking for basic financial information, a statement of how it had used the "grant" money from just one trust -- the Williams Trust -- in the preceding three years, and for reasons why NYCT should continue to make Williams Trust distributions to CSS. R2729-30. CSS promptly provided the requested information (R2732-33), and never received any indication from NYCT that its response was in any way unsatisfactory. CSS had received similar inquiries about the Williams Trust previously. *See supra*, at 10 n.9. The request, therefore, was neither surprising nor unusual; certainly nothing to indicate that a variance exercise was imminent.

Ten months later, in March of 1971, NYCT temporarily suspended CSS's right to receive monies, but said nothing to CSS on the subject until the late spring. At that point,

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[32/] In holding that CSS's claims were not barred for the six year period prior to the filing of this proceeding, the Surrogate relied on the principle stated in *Sippell* v. *Hayes*, 189 Misc. 656, 69 N.Y.S.2d 852 (Sup. Ct. Oneida County 1947). In *Sippel*, the trustee had withheld payments for twelve years, and the applicable statute of limitations was ten years. The *Sippel* court stated that "[r]ecovery of [only those] payments which became due more than 10 years before the commencement of the action is barred." 656 Misc. at 663, 69 N.Y.S.2d at 858. The court thus held that where a trustee has repudiated his obligation to make payments to the trust beneficiary, the statute of limitations only begins to run as to a payment at the time such payment was repudiated. The principle of *Sippell* also applies in actions for accountings and in situations analogous to the trust context. *See Airco Alloys Div.* v. *Niagara Mohawk Power Corp.*, 76 A.D.2d 68, 80, 430 N.Y.S.2d 179, 186 (4th Dep't 1980); *Gleason* v. *Ritchie*, 267 A.D. 447, 449, 47 N.Y.S.2d 38, 39-40 (4th Dep't 1944) (per curiam); *Gruby* v. *Brady*, 838 F. Supp. 820, 831 (S.D.N.Y. 1993); *McCaw* v. *McCaw*, 182 Misc. 910, 912, 47 N.Y.S.2d 950, 951-52 (Sup. Ct. Kings County), *aff'd*, 268 A.D. 866, 50 N.Y.S.2d 766 (2d Dep't 1944).

it was of course impossible to give notice of a complete repudiation, because the Distribution Committee had not yet acted, and only a temporary suspension to permit further inquiry was in place. NYCT memoranda to files dated May 12, 1971 (R2825) and June 21, 1971 (R2838), which indicate that Mr. West purported to have told Dr. Emerson and Mr. Mulreany of CSS that automatic payments to CSS would cease -- even taken at face value -- do not show that NYCT conveyed to CSS the notion of a *complete* repudiation of all interest in the trusts and of all NYCT's duties to CSS. The then Chairman of the Distribution Committee, William Parsons, conceded as much, testifying that the West memorandum (of May 12, 1971) "[d]efinitely [does] not" reflect a comment by Mr. West to CSS that the Distribution Committee had decided to exercise the variance power, but only "would suggest . . . that the decision was made that we should review and not be automatic." R3452. In addition, Ms. Grants testified that she was present at the meeting referred to in the June 21, 1971 memorandum and does not "believe [Mr. West] told them whatever that says because it had not happened." R2364-65.[33/]

NYCT also argues that Dr. Emerson's testimony that he understood there would no longer be "automatic" payments to CSS amounts to a recognition of repudiation of its designated beneficiary status sufficient for statute of limitations purposes. App. Br. 27. This is wrong. To constitute a clear, open and unequivocal repudiation, the trustee must openly

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33/ Relying on the May 12, 1971 West memorandum and the testimony of Mr. Wainwright, NYCT argues that Mr. Mulreany, CSS's Chairman of the Board "was also fully aware of the repudiation of automatic payments from the funds." App. Br. 27-28. For reasons stated *supra*, at 44-45, the May 12, 1971 memorandum is neither reliable nor indicative of a repudiation by NYCT. Mr. Wainright's testimony describing an overheard street corner conversation did not suggest notice of an unequivocal repudiation. Its reliability, moreover, is open to grave doubt. Mr. Wainwright testified that he could not remember any other significant details of the purported conversation, including what time of year it took place (or if it took place in 1971 at all). R2235-37, 2247-48, 2251. In fact, he has no memory of the entire period as it relates to NYCT (including his attendance at the Distribution Committee meetings) except for this singular recollection. R2235-37.

disavow any and all rights the beneficiary has to the trust. *See supra*, at 41-42. Dr. Emerson testified he was never advised there would be a change in the relationship between CSS and NYCT, only that "there would be a different process by which payments would be made available." R2025-28. Dr. Emerson did not recall ever having been told that CSS would have no further interest in the six trusts, and he testified that he did not expect that there would be any reduction in funds from NYCT, but that NYCT would continue to provide trust benefits to CSS. R2061-62.

Dr. Emerson further testified that he was never advised of any criticism by NYCT of any aspect of CSS's new directions, but, on the contrary, felt strongly encouraged by NYCT, and particularly by Ms. Grants. R2028, 2064. Dr. Emerson's understanding was substantiated by Ms. Grants, who testified that the Distribution Committee had instructed the staff to talk to CSS about developing new ways to work together (R2501), and that the ensuing discussions between NYCT and CSS were "extremely cordial" (R2364).

As previously noted (*supra*, at 17-18), moreover, NYCT's written communications to CSS in September of 1971 did not give clear notice of variance. Although the Distribution Committee decided to send a termination letter to each charity that had been subject to an exercise of the variance power (R2940; R2947; R2950), including The Salvation Army (R524; R3039-40), there is no evidence (and NYCT does not contend) that one was sent to CSS. And while it is open to question whether even that letter would have sufficed, the decision to omit CSS from the mailing confirms CSS's unique status.

Indeed, while others were being advised of their changed status, CSS was sent an entirely different kind of letter by Mr. West, informing it of a large grant from the same trusts from which CSS previously had been receiving payments for years. R2945-46. The

fact that this letter "made no mention of any entitlement of CSS to automatic income from the funds" (App. Br. 28-29) is hardly a clear and open repudiation of all interest in the trusts, particularly given that the letter speaks of NYCT and CSS working together on future projects, and praises the very CSS "new directions" that -- unbeknownst to CSS -- were the supposed basis for NYCT's variance exercise. Nowhere in the letter did Mr. West indicate that the variance power had been exercised or that the accompanying payment from the trusts represented a "terminal payment," although the letter afforded NYCT a clear opportunity to make that point. Dr. Emerson testified that he felt the letter was "enthusiastic," and that it raised no questions in his mind about future payments from NYCT. R2025.

The apparent decision not to send CSS a termination letter and the pointed omission of any reference to the variance exercise in the September West letter was not accidental. As Ms. Grants testified at trial (R2360-61):

> Q: Nobody wanted a break with CSS, did they?
>
> A: Absolutely not.
>
> Q: Nobody wanted to say to them, this money was for you, but [you've] got no more interest in it at all?
>
> A: No. In fact, the distribution committee asked the staff to do quite the opposite . . . .

NYCT asserts that prior to 1971 it made separate automatic distributions to CSS with transmittal notices specifically referring to the six trusts, but that not all transmittal notices after 1971 referred to those trusts. App. Br. 30. NYCT thus implies that CSS should have understood a difference between "automatic" payments from the six trusts and discretionary grants from the six trusts and other trusts. This argument is fallacious. The applicable legal

standard for finding a repudiation does not require a trust beneficiary to parse transmittal letters in order to draw subtle distinctions that might bear on whether its rights in the trusts had been repudiated. Moreover, even assuming CSS did note a difference, it does not follow that CSS should have understood that a failure to receive grants "automatically" meant that all of CSS's interests in the trust funds had been repudiated. Indeed, as Ms. Slutsky testified at trial, none of NYCT's grants really are made "automatically." R2221.

CSS continued to be treated as a preferential designee. Despite NYCT's assertion that CSS was "like any prospective charitable grantee seeking discretionary funds" (App. Br. 31),[34] the evidence overwhelmingly supports the Surrogate's contrary finding that "CSS was accorded preferential treatment in review of grants" (R17(16)). This too undercuts the claim that the fiduciary relationship was ever fully repudiated.

Indeed, NYCT was itself ambivalent in the way it exercised the variance power. The variance resolutions adopted with respect to the Williams Trust and the Griffith Trust expressly provide that "preference [is to be] given to [CSS] in support of key projects." R2935-36. And immediately after the variance vote was taken, the Distribution Committee authorized the de Diego-Beekman grant payment to CSS "from funds in which [CSS] is a preferential designee." R2934. Thereafter, NYCT documents repeatedly refer to CSS as having preferential designee status. *See, e.g.*, R2935-36; R3103; R3105; R3120-22; R3131-32. This status also was referred to in communications with CSS. R3318.

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[34] In support of this statement, NYCT cites pages 2094 and 3554-55 of the Record. Page 2094 (testimony of Mr. Whelan) does not even mention CSS or grant applications. Pages 3554-55 is a letter from Mr. West to CSS stating that NYCT had approved a grant to CSS, which would be derived from the Williams Trust, thus indicating that CSS was not like every other grantee when it came to Williams monies.

Moreover, Mr. Whelan, an NYCT staff member from 1972 to 1991, testified that under special procedures (sometimes referred to as "due consideration" procedures) NYCT had an obligation to review each fund in which a preferential designee was named and, if a grant had not been made to the preferential designee within the past four years, to initiate a grant by soliciting a proposal. R2078-79, 2082-85; *see also* R3103. This is consistent with Ms. Grants concession at trial (reaffirming her deposition testimony) that after 1971 a grant application from CSS would go "right to the top of the heap," meaning that the NYCT staff would consider approving and sending it to the Distribution Committee even before reading other grant proposals. R2451, 2495-96. This conduct too is inconsistent with a clear, open and unequivocal repudiation.[35/]

The significant distributions made to CSS by NYCT in the years immediately after the 1971 exercises of the variance power also were consistent with (and must have reinforced) CSS's understanding that it had a continuing special relationship with NYCT arising out of the trusts at issue. *See* R3326; R2164-67 (Slutsky). NYCT's assertion that discretionary grants to CSS *from the six trusts* averaged only $28,360 per year between 1971-1995 (App. Br. 31) fails to tell the full story. NYCT made total annual grants to CSS in each year from 1971 to 1986, that were, on average, comparable to payments CSS had received from NYCT annually prior to 1971. R3164, 3166. A trust beneficiary receiving checks from its trustee is not on notice of a complete repudiation of the trust relationship

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35/ Most recently, in 1993, NYCT amended its statement of trust purpose regarding the Adler Trust (which since September of 1971 had included no specific reference to beneficiaries) to add that in making grants, there should be "due consideration" given to the named beneficiaries, including CSS. R3144; *see also* R2206-08 (Slutsky). What better proof that NYCT had not repudiated "any and all" interests than this additional and very recent recognition by NYCT of its continuing trust obligation?

simply because the checks are in varying amounts and look different than they used to. The payment record on this was further confused by several factors:

- Pre-1970 discretionary grants to CSS from NYCT averaged less than $1,000 per year, but after 1971 ballooned so that the total annual amounts received by CSS in the 1970s and early 1980s were on a par with previous years. R525; R3166.

- Even "automatic" trust fund income obviously varies from year to year depending on investment performance. *See* R3164 (showing fluctuations prior to exercise of variance power).

- The Griffith Trust was varied before CSS received even one "automatic" payment. R2896. There was therefore no basis for historical comparison.

- Payments from the Prince Trust, which were not in response to grant applications, continued after the Distribution Committee secretly reversed its prior variance decision as to that Trust. *See supra*, at 18-19.

- Episodic payments were made from the Bonynge Trust, which had not been varied but had been left to the discretion of NYCT's director. R17(16); R2881.

- NYCT and CSS developed an explicit arrangement under which NYCT would fund CSS programs for the direct relief of poor persons using all of the income of the Williams Trust. R3079-80; R3317. This arrangement appears to have been followed in 1975 and 1976 (*see* R3317), and largely parallels procedures in place prior to 1971 (*see, e.g.*, R3284; R3285-89; R3522).

As the Surrogate found, "[i]n light of the continued flow of funds, albeit in reduced amounts, the beneficiary cannot be charged with knowledge of repudiation." R17(16 n.6).[36/]

On a final note with regard to the statute of limitations, contrary to NYCT's assertion (App. Br. 35), the facts regarding CSS and The Salvation Army are vastly different. First of all, The Salvation Army -- unlike CSS -- received a termination letter, presumably in the

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[36/] NYCT's assertion that "the Surrogate's ruling would appear to require a complete severance between NYCT and CSS in order to establish a 'repudiation'" (App. Br. 30) is incorrect. The fact that CSS received grant money from NYCT is not, standing alone, what "muddied the waters." Rather, it is the special status CSS continued to enjoy after 1971, along with the absence of a plain English notification of NYCT's true position, that prevented effective repudiation.

form quoted *supra*, at 17. R524; R3039-40. Second, numerous documents cited by the Surrogate in her June 15, 1998 opinion demonstrate that The Salvation Army understood not only that automatic payments had been terminated but that, going forward, it would be in no different position than any other charity that might apply for discretionary grants.[37/]

The documents to which the Surrogate referred establish that, as a result of NYCT's 1971 action, The Salvation Army had effectively been notified that it would not receive *any* further payments from the Rockefeller Trust except by competing against all applicants on a non-preferential basis. For example, The Salvation Army's documents noted specifically that income of the Rockefeller Trust had been "placed under the control of [NYCT]." R1654. The Salvation Army documents thus show that The Salvation Army knew NYCT had repudiated "any and all interest" of the Army in the Trust.[38/]

[37/] As the Court further noted, The Salvation Army decided to delete the Rockefeller Trust from its internal records, after concluding that it "appears quite unlikely" that it would receive distributions from this trust at a later date. R1653-54.

[38/] Recognizing that this Court's decision in The Salvation Army appeal implicitly rejected the argument that the statute of limitations should not apply to an action by a charitable trust beneficiary against the trustee, CSS does not address the point except in this footnote.

There are clear public policy reasons that support such a rule particularly with regard to future payments. The underprivileged of New York City, who should be receiving money from CSS today, may not have been underprivileged (or even born) in 1971 when NYCT claims to have repudiated its obligations, or in 1977 when NYCT claims the statute of limitations expired. Certainly they knew nothing of the six trusts or their purposes. To say that those ultimate beneficiaries should be ignored or deprived because of the supposed inaction of CSS administrators years ago defeats the policies that support the creation, enforcement and special protection of charitable trusts merely because of the passage of time. *See* IVA William F. Fratcher, *Scott on Trusts*, §392 at 380 (2d. ed. 1989); *see also Mount Vernon Mortgage Corp.* v. *United States*, 236 F.2d 724, 725 (D.C. Cir. 1956) (quoting *Ould* v. *Washington Hosp.*, 95 U.S. 303, 313 (1877)). We also understand that this issue will be addressed fully by the Attorney General.

B. CSS's Claims Are Not Barred by Laches.

A party asserting laches bears a heavy burden where, as here, the applicable statute of limitations has not yet run. *See Reconstruction Fin. Corp.* v. *Harrison & Crosfield, Ltd.*, 204 F.2d. 366, 370 (2d Cir. 1953). Application of laches depends on a weighing of the equities, and here the equities weigh heavily in CSS's favor.[39/]

First, the delay stems from NYCT's failure to give unequivocal notice that it intended to repudiate all of its obligations to CSS under the trusts (assuming that is what NYCT intended despite its ambivalent designation of CSS as a "preferential designee"). Because of the failure to give unequivocal notice, the subsequent annual payments and only a gradual decline in the relationship, CSS's current staff were by 1993 unaware of CSS's rights under the trust instruments. Once this was discovered (through Chemical Bank's inadvertent disclosure, *see* R1949-50 (Jones)) CSS acted forcefully to inquire into its rights and, when all efforts at compromise failed, commenced this litigation.

Second, despite NYCT's assertion of prejudice from the possibility that evidence may have been lost, discovery in this case produced an extensive record; and there is no indication that relevant documents are missing.[40/] Similarly, the testimony of key witnesses, including the Chairman of the Distribution Committee in 1971, a key 1971 staff member and NYCT's 1971 outside counsel (all of whom attended the relevant Distribution Committee meetings) was available to the Surrogate. *See* discussion of available evidence, *supra* at 7-9.

[39/] Moreover, as pointed out by the Surrogate, the affirmative defense of laches "is unavailable where [as here,] the beneficiary is unaware of the fiduciary's repudiation." R17(16) (citing *Barabash*, 31 N.Y.2d 76, 286 N.E.2d 268, 334 N.Y.S.2d 890).

[40] NYCT's references to a "warehouse fire" have no record support and are purely speculative. *See supra*, at 8 n.6.

Third, the defense of laches is barred if the proponent of the defense has unclean hands.[41] *See Matter of Uciechowski*, 221 A.D.2d 866, 867-68, 634 N.Y.S.2d 251, 252 (3d Dep't 1995) (respondent's unclean hands preclude assertion of defense of laches against petitioner); *Matter of Coger*, 191 A.D.2d 493, 494-95, 594 N.Y.S.2d 332, 333 (2d Dep't 1993) (same). Here NYCT concealed its variance decision from CSS and affirmatively led CSS to believe it had not repudiated CSS's entire trust interest. Among other things, NYCT (i) gave no notice in writing to CSS of its supposed repudiation; (ii) continued under its revised grant procedures for years to make payments comparable to the prior automatic payments, thereby lulling CSS into thinking it would get what it was due so long as it did the necessary paper work (R2061-62 (Emerson); R3166); and (iii) when it finally ceased making payments, it did so after a change in senior management at CSS, with the result that the new Chief Executive was ignorant of the evolution of the "special relationship" that NYCT had previously enjoyed (R1905, 1949; R3166 (Jones)). None of this reflects the forthright conduct CSS had the right to expect from NYCT, with the consequence that NYCT should be barred from asserting laches.

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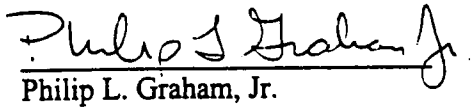
[41] The facts establishing NYCT's unclean hands also demonstrate that NYCT should be equitably estopped from invoking the statute of limitations. *See Valle* v. *Joint Plumbing Indus. Bd.*, 623 F.2d 196, 202 n.10 (2d Cir. 1980) ("[t]he defendants [a pension fund] having thus lulled [plaintiff, a fund beneficiary] into the belief, for a 3 1/2 year period, that a lawsuit might not be necessary, they are equitably estopped from relying on that period in order to invoke the bar of the statute of limitations") (citations omitted); *see also Erbe* v. *Lincoln Rochester Trust Co.*, 13 A.D.2d 211, 213, 214 N.Y.S.2d 849, 852 (4th Dep't 1961) ("[i]t should not be held that a trustee can take advantage of the limitations statute when the beneficiaries of the trust may have been led to believe that there was no breach of the relationship by statements of false facts or concealment of true facts by the fiduciary"), *appeal dismissed*, 10 N.Y.2d 819, 178 N.E.2d 420, 221 N.Y.S.2d 713 (1961) *and* 11 N.Y.2d 754, 181 N.E.2d 629, 226 N.Y.S.2d 692 (1962); *Matter of Pettit's Will*, 38 Misc. 2d 818, 819-20, 238 N.Y.S.2d. 844, 846 (Sur. Ct. Nassau County 1963); *Rank Org. Ltd.* v. *Pathe Labs, Inc.*, 33 Misc. 2d. 748, 754, 227 N.Y.S.2d 562, 568-69 (Sup. Ct. New York County 1962).

CONCLUSION

For the foregoing reasons, the Surrogate's decision should be upheld, except to the extent that it bars CSS's claims for the period prior to six year before the date CSS filed its petitions.

Dated: New York, New York
March 1, 2000

Respectfully submitted,



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STATE OF NEW YORK
SURROGATE'S COURT: COUNTY OF NEW YORK

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In the Matter of the Application of the Community Service Society of New York to Compel Barbara Scott Preiskel, Barry H. Garfinkel, Alberto Ibargüen, Anne Eristoff, Lulu C. Wang, Arthur G. Altschul, Bruce L. Ballard, M.D., Charlotte Moses Fischman, Robert M. Kaufman, William M. Evarts, Jr., Lorie A. Slutsky and Carroll L. Wainwright, Jr., as Members of the Distribution Committee of the New York Community Trust, and Chase Manhattan Bank, N.A. or Bankers Trust Company, as Trustees Under the Instruments made by

THE LAURA SPELMAN ROCKEFELLER MEMORIAL,	File No. 4213/95
MORTON L. ADLER,	File No. P506/40
ALINE S. FRANK,	File No. P1275/54
NETTA L. FRANK,	File No. P1851/55
HENRY K.S. WILLIAMS, and	File No. 4212/95
LINDA A. GRIFFITH	File No. P1793/49

as Grantors, for the Benefit of the Community Service Society, to Make and Settle an Intermediate Account of Their Proceedings as Such Trustees, and for an Order Directing Distribution of Income

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PRE-ARGUMENT STATEMENT

1. **Title of the Action:** In the Matter of the Application of the Community Service Society of New York ("CSS") to Compel Barbara Scott Preiskel, Barry H. Garfinkel, Alberto Ibargüen, Anne Eristoff, Lulu C. Wang, Arthur G. Altschul, Bruce L. Ballard, M.D., Charlotte Moses Fischman, Robert M. Kaufman, William M. Evarts, Jr., Lorie A. Slutsky and Carroll L. Wainwright, Jr., as Members of

the Distribution Committee of the New York Community Trust ("NYCT"), and Chase Manhattan Bank, N.A. or Bankers Trust Company, as Trustees Under the Instruments made by The Laura Spelman Rockefeller Memorial, File No. 4213/95, Morton L. Adler, File No. P506/40, Aline S. Frank, File No. P1275/54, Netta L. Frank, File No. P1851/55, Henry K.S. Williams, File No. 4212/95, and Linda A. Griffith, File No. P1793/49 as Grantors, for the Benefit of the CSS, to Make and Settle an Intermediate Account of Their Proceedings as Such Trustees, and for an Order Directing Distribution of Income.

2. **Full Names of Original Parties and Any Change in the Parties:** Community Service Society of New York, Barbara Scott Preiskel, Barry H. Garfinkel, Alberto Ibargüen, Anne Eristoff, Lulu C. Wang, Arthur G. Altschul, Bruce L. Ballard, M.D., Charlotte Moses Fischman, Robert M. Kaufman, William M. Evarts, Jr., Lorie A. Slutsky and Carroll L. Wainwright, Jr., as Members of NYCT's Distribution Committee, and Chase Manhattan Bank or Bankers Trust Company, as Trustees, and the Office of the Attorney General of the State of New York.

3. **Name, Address and Telephone Number of Counsel for Appellants/Cross-Respondents:**

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4. **Name, Address and Telephone Number of Counsel for Respondents/Cross-Appellants:**

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Counsel for CSS

Robert Molic, Esq.
Office of the Attorney General of the State of New York
Charities Bureau
120 Broadway
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Counsel for Charitable Beneficiaries

5. **Court From Which Appeal is Taken:** Surrogate's Court (Preminger, J.), New York County.

6. **State the Nature and Object of the Cause of Action or Special Proceeding:** CSS initiated a proceeding to compel an accounting by NYCT for six trusts administered by NYCT and for a distribution of income from these six trusts. CSS contended and continues to contend that in 1971 the Distribution Committee of NYCT wrongfully exercised its variance power terminating CSS's status as a designated beneficiary of the six trusts.

7. **State the Results Reached in the Court Below:** After a five-day bench trial, the Surrogate's Court (Preminger, J.) held that the decision of NYCT's Distribution Committee to exercise its variance power terminating CSS's status as a designated beneficiary of the six trusts was unsupported and ordered an accounting. The Court held that "the statute of limitations applicable to accounting proceedings does not

bar CSS' claims for the period six years prior to the commencement of these proceedings; and . . . that the doctrine of laches does not bar CSS' claims." It also held, however, that CSS is not entitled to an accounting for the period prior to six years before the commencement of the current proceedings.

8. **State as Briefly as Possible the Grounds for Seeking a Reversal:** The Surrogate erred in holding that CSS's claims for the period prior to six years before the date CSS filed its petitions are barred by the statute of limitations. First, the Surrogate failed to recognize that because NYCT is a charitable entity dedicated to public purposes, the statute of limitations is not applicable here. Second, even if the statute of limitations does apply, the Surrogate erred by finding that it began to run. Trust repudiation sufficient to commence the running of the statute must be clear, open and unequivocal. In particular, the trustee either must renounce its obligation to administer the trust or deny the trust's existence. NYCT's communications with and actions toward CSS did not amount to a repudiation commencing the statute of limitations period. Finally, because NYCT's statements and continuing conduct both effectively concealed from CSS any repudiation NYCT may have made and misled CSS into believing litigation was not necessary to preserve its rights, the Surrogate erroneously held that NYCT is not equitably estopped from asserting the statute of limitations as a defense.

9. **Related Actions:** A petition was filed by the Salvation Army seeking to overturn NYCT's decision in 1971 to exercise its variance power to terminate distributions of income to the Salvation Army from the Rockefeller Trust. After finding that the facts surrounding NYCT's exercise of the variance power as to the Salvation

Army were very different from the facts surrounding the exercise of the variance power as to CSS, the Surrogate dismissed the Salvation Army's petition by application of the six year statute of limitations. The Surrogate's decision was affirmed by this Court by decision entered March 4, 1999. *In re Application of the Community Service Society of New York, etc., The Laura Spelman Rockefeller Memorial, etc., The Salvation Army* v. *New York Community Trust, etc.*, No. 449.

Dated: New York, New York
December 17, 1999

Respectfully submitted,

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To Be Argued By:
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SUPREME COURT OF THE STATE OF NEW YORK
APPELLATE DIVISION: FIRST DEPARTMENT

In the Matters of:	
The Laura Spelman Rockefeller Memorial;	File No. 4123/95
Morton L. Adler;	File No. P506/40
Aline S. Frank;	File No. P1275/1954
Netta L. Frank;	File No. P1851/1955
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Linda A. Griffith,	File No. 1793/49
Deceased.	

BRIEF OF CROSS-APPELLANT NEW YORK STATE ATTORNEY GENERAL ON BEHALF OF UNNAMED ULTIMATE CHARITABLE BENEFICIARIES IN SUPPORT OF THE DECREE BELOW, ON MODIFIED GROUNDS

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

Cases, cont.:

Cases, cont.:

Statutory and Regulatory Authorities:

Other Authorities:

SUPREME COURT OF THE STATE OF NEW YORK
APPELLATE DIVISION: FIRST DEPARTMENT

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BRIEF OF CROSS-APPELLANT NEW YORK STATE ATTORNEY GENERAL ON BEHALF OF UNNAMED ULTIMATE CHARITABLE BENEFICIARIES IN SUPPORT OF THE DECREE BELOW, ON MODIFIED GROUNDS

PRELIMINARY STATEMENT

The Attorney General of the State of New York, representing the unnamed, ultimate charitable beneficiaries of charitable trusts administered by appellant New York Community Trust ("NYCT"), urges this Court to modify and, as modified, affirm the decision of the Surrogate below granting an accounting to cross-appellant Community Service Society ("CSS"), on the following basis: (1) the exercise of NYCT's unilateral variance power is reviewable by this Court; (2) the exercise of said power in 1971 was invalid because NYCT did not provide notice to the Attorney General; and (3) the exercise of said power in 1971 upon the purported criterion of "undesirability" was also invalid because (a) NYCT failed to apply "undesirability" in accordance with its own stated policies and its donors' respective intentions concerning uses of their funds when circumstances change, and (b) NYCT

misapplied "undesirability" to remove restrictions that had been imposed by the donors, thereby apparently enabling NYCT to apply such funds to its general charitable purposes on an unrestricted basis.

Upon his cross-appeal, the Attorney General further urges this Court to modify the decree below to hold: (1) that the enforcement of a charitable trust by the Attorney General, acting on behalf of the trust's unnamed, ultimate charitable beneficiaries, is not barred by any limitations of action applicable to the State itself; and (2) that an equitable accounting must encompass the entire administration of the trust (to the extent not previously settled by judicial account), if only to determine the uses to which NYCT applied the charitable funds freed from restriction by its exercise of the variance power.

QUESTIONS PRESENTED

1. Did the Surrogate properly reject the NYCT Distribution Committee's 1971 exercise of its community trust "variance power" to terminate automatic income distributions from six trusts to CSS?

The Surrogate properly reviewed and correctly invalidated the purported exercise of that power in 1971 by the Distribution Committee.

2. Did the Surrogate correctly uphold the procedures employed by the Distribution Committee in its 1971 exercise of the variance power?

The Surrogate erred as a matter of law by not requiring that notice be afforded the Attorney General, as the representative of the trusts' unnamed, ultimate charitable beneficiaries, of NYCT's intention to exercise such power.

3. Did the Surrogate correctly hold that NYCT improperly varied the trusts designating CSS as a beneficiary on the substantive ground of "undesirability"?

The Surrogate erred as a matter of law only insofar as she required such a finding to derive from specific "negative" information concerning the beneficiary, rather than requiring NYCT to determine "undesirability" according to its donors' expressed intentions for the uses of their funds in the event of changed circumstances.

4. Did the Surrogate err as a matter of law in expressing an opinion, unnecessary to the decree below, that the six-year Statute of Limitations applied to the Attorney General's power to enforce charitable trusts on behalf of unnamed, ultimate charitable beneficiaries?

Actions by the Attorney General to enforce charitable trusts on behalf of their unnamed, ultimate charitable beneficiaries are not subject to a limitations period, and no such limitation should be held to bar the Attorney General in this case.

5. Did the Surrogate err as a matter of law in applying a six-year Statute of Limitations to the accounting she decreed?

The Surrogate erred in fashioning a "partial" accounting because an accounting must address the entire administration of the trust, from the inception of the trust or from the last time the trustee accounted.

STATEMENT OF THE CASE

Relevant Facts

The New York Community Trust ("NYCT"), together with its corporate affiliate, Community Funds, Inc., is the largest community foundation in the country. It currently holds more than $1.5 billion in assets and is by far the largest charitable entity serving the New York City area.[1] NYCT describes its governing body as "leaders in the New York City community with pre-eminent reputations in the fields of finance, law, education, medicine and the arts." Appellants' Brief (hereinafter "NYCT Br.") at 5.

As a community foundation, NYCT -- together with its trustee banks -- holds charitable funds and distributes the income thereof as a fiduciary, pursuant to donors' instructions, as set forth in gift instruments, each of which incorporates the NYCT Resolution and Declaration of Trust ("R & D"). R. 17-2. Some NYCT donors leave the income distribution decisions for their gifts entirely within the discretion of NYCT's governing body, *i.e.*, its Distribution Committee. R. 17-3. Others provide very specific instructions for the uses of their gifts, including lists of named beneficiaries; these are termed "designated funds." *Id.* All NYCT funds are subject to the R & D, which includes a provision, termed a "variance power," allowing the Distribution Committee to deviate from a donor's instructions as follows:

> [I]f and whenever it shall appear to the Distribution Committee . . . that circumstances have so changed since the execution of the [gift instrument] as to render unnecessary, undesirable, impractical or impossible a literal compliance with the terms of such instrument, said Committee . . . may at any time . . . direct the application of such gift . . . to such other public educational, charitable or benevolent purpose as, in

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1 *See* Record on Appeal at 2137. Citations to the Record on Appeal appear as "R. [page]."

> their judgment, will most effectually accomplish the general purpose [of NYCT], without regard to and free from any specific restriction.

R. 17-3, 17-4. This variance power is designed to provide a mechanism enabling community foundations to redirect charitable trust funds in the specific circumstances and manner set forth in the R & D, and to be able to do so on a unilateral basis, *i.e.*, without judicial *cy pres* proceedings. R. 17-4.

The Community Service Society ("CSS") is a New York not-for-profit corporation that has provided, for more than 150 years, a wide range of individual service, community organizing and public advocacy programs aimed at improving the lives of New York City residents living in poverty. R. 17-5. Although CSS implemented a 1971 report calling for its many of its services to be moved out of its centralized location and into the communities it served, direct service to individuals remained a "large component" of its work at all times. R. 17-5, 17-7.

CSS was listed as a named beneficiary with respect to each of the six NYCT designated trust funds at issue in this case. R. 17-5. At all times material to this case, CSS' work has been recognized as of high quality, "widely respected by the NYCT and the philanthropic community." R. 17-5.

At the time the various NYCT trusts and bequests naming CSS were drawn, NYCT's executive director encouraged the establishment of designated funds, whereby donors specified the beneficiaries NYCT would pay with their gift, and the variance power was rarely exercised; by 1971, however, when NYCT began the review process leading to the exercise of the unilateral variance power against the CSS gifts, its new executive director had established a preference for discretionary, unrestricted gifts, over designated funds. R. 17-6.

In September, 1971 NYCT exercised its unilateral variance power to terminate CSS' interest in these six funds, on the ground that such payments were "undesirable" within the meaning of the R & D. R. 17-9. However, on the same date it exercised said variance power, NYCT also awarded CSS a substantial discretionary grant from NYCT's unrestricted funds. R. 17-14.

As a result of the simultaneous grant award and other "mixed signals," NYCT's communications to CSS concerning the exercise of the unilateral variance power "fell short of conveying to CSS notice of a complete termination of its interests" and "muddied the message of an otherwise clear repudiation" of the trusts at issue here. R. 17-15 to 17-16.

Following her decision below, R. 17-1 to 17-17, the Surrogate signed a decree ordering NYCT's trustees "to judicially settle their account as trustees . . . in each case for the period of October 13, 1989 to the present." R. 17.

Interest of the Attorney General

The Attorney General of the State of New York is charged with the oversight of charitable asset administration throughout the State and with the protection of the ultimate charitable beneficiaries of public charities, charitable trusts, private foundations and not-for-profit corporations. N. Y. EST. POWERS & TRUSTS LAW ("E.P.T.L."), § § 8-1.1, 8-1.4; N. Y. EXEC. LAW § 175; N.Y. NOT-FOR-PROFIT CORP. LAW ("N.P.C.L.") § 112 .

The Attorney General was not initially cited by CSS in the accounting petitions commencing these proceedings. R. 34-46. Nevertheless, mindful of the potential significance of the case, the Attorney General closely monitored the case and attended the proceedings, with the consent

of both parties. At the request of the Surrogate just prior to the commencement of trial, the Attorney General joined as a party, by Notice of Appearance dated April 9, 1998.

The Attorney General did not participate in the trial below, as the bulk of the issues before the Surrogate turned on intricate questions of fact, ably presented by NYCT, CSS and their counsel. However, during the time for post-trial submissions, the Attorney General submitted a letter urging the Surrogate to require notice to the Attorney General in connection with any exercise by NYCT of its unilateral variance power. R. 3959.

Following the issuance of the opinion and decree below, the Attorney General has now aligned as respondent with CSS for the purposes of urging the affirmance of the decision below invalidating NYCT's exercise of its unilateral variance power against CSS in 1971. Along with CSS, the Attorney General urges this Court to hold that the Surrogate correctly found the variance power exercise subject to judicial review and properly applied a narrow construction to this power, consistent with applicable law and public policy. *See* Point I.A, *infra*.

While the Surrogate did not ground her decision below upon procedural flaws in NYCT's exercise of the unilateral variance power, the Attorney General contends that NYCT's failure to provide any notice to the Attorney General of its exercise of the variance power in 1971 provides an independent ground for overturning the actions taken at that time, and as such, an equally compelling basis for upholding the decree below awarding relief to CSS. *See* Point I.B, *infra*.

The Attorney General also argues, contrary to the Surrogate's decision, that when the NYCT Distribution Committee sought to exercise its unilateral variance power on the basis of "undesirability," it was required to determine (only) whether, in light of changed circumstances, the

fund's original donor would have found further distributions undesirable, without regard to any positive or negative views the Committee itself may have concerning the beneficiary or the changed circumstances. *See* Point I.C, *infra*. While this legal standard differs somewhat from that applied by the Surrogate below, the Attorney General contends that the result remains the same: the exercise of the variance in 1971 failed to satisfy the test.

While seeking affirmance of the result below, the Attorney General also filed a Cross-Appeal. R. 8-10. In addition to urging the modifications to the standard of review applicable to the variance power exercise, as articulated above, the Attorney General's Cross-Appeal further contends that the Surrogate erred insofar as she purported to apply a six-year Statute of Limitations to actions by the Attorney General to enforce charitable trusts on behalf of their unnamed, ultimate beneficiaries.[2] *See* Point II.A, *infra*. The Attorney General also contends on the Cross-Appeal that the Surrogate erred in decreeing only a partial accounting, because there is no way to calculate even six-years' worth of recoveries without a full accounting of the administration of the trusts to document the trustees' receipts and expenditures. *See* Point II.B, *infra*. This point is especially important, because NYCT must account to the Attorney General for how it spent the funds freed by its exercise of the unilateral variance power.

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[2] On January 12, 2000, NYCT moved to dismiss this portion of the Attorney General's Cross-Appeal; on January 24, 2000, the Attorney General opposed said motion. The motion is *sub judice*.

ARGUMENT

POINT I

NYCT BREACHED ITS FIDUCIARY DUTIES TO ITS UNNAMED ULTIMATE BENEFICIARIES BY EXERCISING ITS "VARIANCE POWER" IN VIOLATION OF APPLICABLE PROCEDURAL AND SUBSTANTIVE STANDARDS

NYCT holds itself out to its universe of potential donors and to a wide range of those donors' charitable beneficiaries as a singularly dedicated and qualified guardian of charitable assets devoted to the needs of the public, particularly in the New York City area. NYCT claims that the unilateral variance power at issue here "lies at the heart of all community foundations," and that the decision below will "chill [NYCT's] proper and innovative functioning." NYCT Br. at 1. This is not true. Donors contribute to NYCT and other community foundations for many reasons and in many ways. The unilateral variance power at issue in this case primarily affects gifts to which donors attach significant restrictions.[3]

Moreover, Surrogate Preminger unequivocally upheld NYCT's variance power, R. 17-4, and no one here challenges either the existence or validity of the unilateral variance power in the administration of community foundations. The Attorney General, as the protector of charitable assets throughout the State, concurs with NYCT that its unilateral variance power, if unambiguously made known to donors and to beneficiaries, can serve a valid public purpose by facilitating the reallocation of obsolete charitable gifts short of judicial *cy pres* proceedings.

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[3] As of the time the instant accounting proceedings were commenced, NYCT still held approximately 20% of its total assets in designated funds. Karen W. Arenson , *A Matter of Trust: Two Titans of Charity Battle Over Millions*, NEW YORK TIMES, Oct. 20, 1995 at B1 [all cited articles available on Lexis/Nexis]. This 20% figure may be fairly assumed to have declined thereafter, as a result of NYCT's later preference for unrestricted gifts. R. 3424-5.

However, as the Surrogate observed, with this power comes a corresponding duty "to provide donors with the option of making their own choices of beneficiaries, while preserving the efficacy of their gifts should *later circumstances* undermine that choice." *Id.* at 17-10 (emphasis added). At issue in this case is the reviewability of NYCT's exercise of that unilateral variance power. The Surrogate explicitly and correctly recognized that "[d]efining the scope of [NYCT's] discretion so broadly that it can ignore donors' designations would discourage rather than encourage use of community foundations." *Id.* at 17-10, 17-11.

The Attorney General, as the representative of the public interest, urges that the Surrogate correctly held NYCT accountable for its trust, including the exercise of the variance power. As detailed below, the Attorney General argues that this holding finds support in the record and authorities cited by the Surrogate, as well as in several alternative factual and legal rationales.

A. This Court Should Hold NYCT Fully Accountable For Its Exercise Of The Unilateral Variance Power

1. Prior Precedent Has Narrowly Construed Community Foundations' Exercise Of Powers To Vary Donor Designations

NYCT contends that this is a case of first impression, and that the Surrogate's decision threatens the very essence of community foundations' functions. NYCT Br. at 1. While this may be the first such controversy involving a community foundation's variance power in New York, the issues are not new, and community foundations have continued to function notwithstanding appropriate judicial constraint. Courts and regulatory authorities have narrowly construed the exercise of community foundations' variance powers, to ensure that these private entities -- however representative of the larger community they may purport to be -- remain accountable for their determinations.

For example, in *Guaranty Trust Co. v. New York Community Trust*, 56 A.2d 907 (N.J. Ch. 1948), upon a challenge by the testator's relatives, the court reviewed a disposition similar in many respects to the Williams and Griffith gifts at issue in this case and rebuffed NYCT's contention that its unilateral variance power took priority over the testator's specific directions.[4] In addition to creating a charitable fund and designating a specific theater-related charity (which would in turn identify suitable individual beneficiaries), the *Guaranty Trust* donor further instructed that, in the event the original purpose became impracticable, the named charity itself would choose the appropriate new uses for the trust's income, leaving NYCT discretion to do so *only* in the eventuality that the theatrical organizations ceased to exist. *Id.* at 909. NYCT argued that the testator's designations were merely "precatory" in light of its own variance power, and that it could thus act on its own to reallocate the funds. *Id.* at 910. The court correctly rejected this construction:

> The intent of the testator herein is clearly expressed in his testament . . . . The testator intended to insure distribution and application of the net income from his trust fund by . . . Actors' Equity Association and Actors' Fund of America. . . . Notwithstanding the act of . . . incorporating by reference into his will the resolution of The New York Community Trust, his actual intention is readily ascertained from the subsequent detailed terms of his will.

Id. at 913. Similarly in this case, this Court should not adopt NYCT's claim of uncontrolled discretion to vary its donors' instructions, especially as regards the trust instruments which expressly empower the named beneficiary, CSS, to exercise *its* discretion to select ultimate beneficiaries.

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[4] In *Guaranty Trust*, the instrument lodged a trust fund with NYCT with the instruction that its net income "be applied in such a manner and form as shall be determined by the Actors' Equity Association . . . for the purpose of supplying footwear to present and future members . . . and to all needy actors." 56 A.2d at 909. Similarly, in the instant case, the Williams Trust provided that the income thereof was to be "devoted to the material relief of such poor persons . . . as may . . . be designated as appropriate beneficiaries by [CSS]." R. 2588. And the Griffith Will likewise provided that its net income should "be devoted by [CSS] to special cases of poverty and sickness." R. 284.

In another widely-examined case in California, the Attorney General prevented the San Francisco Foundation ("SFF"), which operated pursuant to a trust instrument very similar to NYCT's, from varying the terms of a trust. The testator there specified that SFF use the income from her trust fund to provide "care for the needy of Marin County . . . and for other nonprofit charitable purposes in that county." *In re Estate of Beryl H. Buck*, No. 23259 (Cal. Super. Ct. Marin County 1986) (reprinted in full at 21 U.S.F. L. Rev. 691, 693 (1986)). Upon learning that this fund -- once relatively modest in scale -- had ballooned after Mrs. Buck's death to exceed $250 million (it exceeded $400 million by the time trial began),[5] SFF argued that such a fortune ought to be made available to the other counties it served, because Marin County was one of the nation's wealthiest. *In re Buck*, 21 U.S.F. L. Rev. at 702-6. Like NYCT here, SFF saw "its role as a community foundation as encompassing obligations . . . [including] responsibilities and accountability to the communities [it serves] as opposed to the interests of the trustor or donor." *Id.* at 706.

The California Attorney General urged SFF to document its belief that applying the bequest as designated would result in "charitable saturation" of the needs of Marin.[6] Ultimately, discovering that SFF had not only failed to survey those needs, but had concealed its knowledge of how the trust's income could be properly spent as the donor wished, the Attorney General intervened and prevented SFF from invoking the variance. The Attorney General wrote:

> [O]ur research indicates that the independent variance power of community foundations, recognized in their own charters and by some trust scholars, has not been tested in the California courts, to our knowledge. It is our present view that the use of the variance power in California should be carried out, if at all, in a manner consistent with well

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5 Douglas Bartholomew, *The Battle for the Buck*, LOS ANGELES TIMES MAGAZINE, Dec. 21, 1986, at 22 .

6 Bartholomew, *supra* note 5.

> established California trust law doctrines. To invoke its power, the Foundation should present evidence of changed circumstances or impracticability. . . . *[T]he Attorney General's office believes that any successful modification of this trust must necessarily and logically be founded upon . . . a recognized basis for application of trust modification and cy pres under California law.*

R. 3524-5 (emphasis added). *See also* Ronald Hayes Malone, et. al., *The Buck Trust Trial – A Litigator's Perspective*, 21 U.S.F. L. REV. 585, 610 (1986); Roger G. Sisson, *Relaxing the Dead Hand's Grip: Charitable Efficiency and the Doctrine of Cy Pres*, 74 VA. L. REV. 635, 647 (1988) ("the legal validity and limits of this modification power remain untested in most jurisdictions").

The cases cited by NYCT and the Community Foundation *amici* do not support an unreviewable unilateral variance power. For example, in *Linney v. Cleveland Trust*, the variance power was not at issue; the court upheld a bequest left to a then-novel community trust, but also spoke solicitously of the importance of donor intent expressions:

> Charitable people . . . have the right and discretion to either use their own judgment and designate a plan of their own, of the application of funds and property left by them for any given purpose, or to seek the advice, counsel, assistance, and direction of men and women skilled along these lines of human endeavor.

30 Ohio App. 345, 360-1, 165 N.E. 101, 105-6 (Cuyahoga County 1928). Given this language, there is little reason to believe that the Ohio court would have disregarded a donor's explicit instructions or permitted the foundation to do so.

2. Sound Public Policy Favoring Protection of Donor Intent And Beneficiaries' Rights Also Supports A Narrow Construction Of NYCT's Unilateral Variance Power

As this Court noted in *Board of Trustees of the Museum of the American Indian v. Board of Trustees of the Huntington Free Library*, 197 A.D.2d 64, 85 (1st Dep't 1994), "[d]oubtless it is better in the end for society to reap the benefit of charitable giving even in the form of dispositions imperfectly suited to the achievement of their purposes, than to forego the benefits of charity altogether in the course of pursuing . . . some almost certainly elusive ideal reallocation." *See also* Malone, et. al., *The Buck Trust Trial*, 21 U.S.F. L. Rev. at 638 ("[w]ere the longstanding rights of donors to define the 'good' to which they wished to devote their bounty abolished, and with that right, their reasonable expectations that their wishes would be loyally followed, donors would reexamine and reconsider their giving").

One observer, analyzing the community foundation variance power in the aftermath of CSS' filing of the instant accounting petitions, focused on the public policy impact of NYCT's claim of virtually unfettered discretion:

> Donor confidence is here held hostage to the performance of well intentioned but fallible administrators. A review of the latitude of the variance power and systematic oversight of its exercise are small costs to ensure that confidence. A further possible question: does the abrogation of this ancient legal protection [*cy pres*] for donors by the language of [NYCT's] Resolution and Declaration contravene public policy?

Henry C. Suhrke, *Variance Power and Its Consequences*, PHILANTHROPIC MONTHLY, Sept. 1995, at 6, 11.

In analyzing another controversial case (not involving a community foundation), a different commentator strongly urged deference to donor intent, concluding:

> Without control over . . . their charity, some philanthropists would decrease their level of giving. Therefore, to encourage people to keep giving funds that benefit the public, the law must respect and uphold the wishes of donors even when those wishes are unpopular or seem unwise.

Chris Abbinante, Comment, *Protecting "Donor Intent" in Charitable Foundations: Wayward Trusteeship and the Barnes Foundation*, 145 U. PA. L. REV. 665, 699 (1997).

Enforcing donor intent ensures the preservation and encouragement of charitable giving. For this reason, New York courts have applied *cy pres* conservatively. *See* E.P.T.L. § 8-1.1(c). As this Court declared in the *Museum of the American Indian* case, "the consequence of so easily dispensing with a grantor's directions would be to discourage charitable giving." 197 A.D.2d at 85. *See also In re Lawless' Will*, 194 Misc. 844, 859-60 (Surr. Ct. Kings County 1949) (citing *Matter of Rupprecht's Will*, 271 A.D. 376 (4th Dep't 1946), *aff'd*, 297 N.Y. 462 (1947)).

In New York State, there is a strong public policy favoring the enforcement of donor intent. "[E]quity will afford protection to a donor" through the Attorney General's authority to enforce the terms of such dispositions. *St. Joseph's Hospital v. Bennett*, 281 N.Y. 115, 119 (1939); *In re Will of Lachat*, 184 Misc. 486, 490 (Surr. Ct. N.Y. County 1944). To ensure that donors, including those who give to community foundations, retain confidence in charitable giving, the Attorney General urges this Court to reject NYCT's novel, overbroad, unlimited construction of its variance power, and to constrain the scope of NYCT's discretion consistent with prior case law and the law of charitable trusts generally.

3. The Unilateral Variance Power Was Not Central To All Decisions To Create Designated Funds At NYCT

The record in this case supports neither an express finding nor an inference that most or all of NYCT's donors relied on the existence of that variance power in choosing to name NYCT as the repository of funds otherwise designated for CSS and other specific charities. In all substantial likelihood, many NYCT donors remained completely unaware of the existence unilateral variance power, much less NYCT's efforts to limit its reviewability. Thus, donor intent does not dictate that NYCT be afforded broad discretion in varying the terms of gifts left in its trust.

a. Donors Avail Themselves Of Community Foundations For Many Reasons Besides Unilateral Variance Power

Perhaps in recognition of the importance of donor intent in New York State charitable trust law, NYCT claims that its donors essentially chose NYCT as the repository of their charitable dispositions *because they intended* to avail themselves of that variance power. NYCT Br. at 24. NYCT would have this Court believe that its entire appeal to donors, along with that of the "555 community foundations throughout the United States," NYCT Br. at 1, depends upon the broadest possible construction of the unilateral variance power at issue in this case. Apart from the fact that there is little evidence that NYCT donors were even aware of the variance power, *see* Point I.A.3.b, *infra*, this argument ignores the many other reasons donors have in choosing community foundations to accomplish their goals.

Donors use community foundations to take advantage of the maximum permitted deductions for income tax purposes, in contrast to the tax treatment if funds are given to their private

foundations. Treas. Reg. § 1.170A-9(e); MARILYN E. PHELAN, 2 NONPROFIT ENTERPRISES: LAW AND TAXATION § 22:10 (1999).

As recently detailed in the *New York Law Journal*, community foundations' appeal to donors encompasses such additional factors as:

> [W]ell-defined, articulated missions. . . .
>
> [I]ndependent governing bodies that are broadly representative of the communities they serve. . . .
>
> [R]epositories of expertise and knowledge on non-profit organizations within their specific geographic regions. . . .
>
> Assets . . . professionally managed and audited . . .
>
> [T]he opportunity to name their individual funds in honor of a loved one or for a specific charitable purpose or cause. . . .
>
> [U]nparalleled flexibility in how much donors can donate, the types of assets they can contribute . . . and the way that contributions can be structured.

Kathleen M. Dwyer, *Community Foundations Offer Many Advantages*, N.Y.L.J., Sept. 7, 1999, at 9. *See also* Abbinante, *supra* at 701 (noting the importance to donors of expert assistance, "a donor effectively hires professional managers").

b. No Evidence Establishes That The Unilateral Variance Power Was Material To Any Donor

On the basis of the trial record below, Surrogate Preminger found that during the tenure of NYCT's former executive director (at the time the instant trusts were drafted), "the establishment of designated funds as opposed to discretionary funds was encouraged, and the variance power was rarely exercised." R. 17-6. Substantial evidence in the record below supports these two conclusions. R. 2172-5, 2317-9, 2827, 3406-7.

Thus, some of NYCT's donors -- quite possibly including the trustors whose bequests were varied against the CSS dispositions -- may well not have known of the existence of the unilateral variance power and/or NYCT's expansive reading of its scope. The materials typically provided by NYCT to potential donors strongly de-emphasized the role of the unilateral variance power, terming it a protection "from obsolescence" and promising that NYCT would only "exercise [such] remedial discretion if rigid adherence to an originally expressed purpose becomes *impossible or impracticable* in unforeseen future conditions." R. 2680 (quoting NYCT's 1954 publication, *All Through the Years)* (emphasis added). A decade later, NYCT's annual report highlighted the option for donors to specify charitable dispositions "in any degree of detail." R. 2706. It described the variance as providing discretion as "to be availed of . . . if the more particularized purpose becomes *impossible, unnecessary or impractical* in changed future conditions." *Id.* (emphasis added). Not only did NYCT's description omit any reference to undesirability, but its example of a potential use of the unilateral variance power was that if cancer were conquered, bequests targeted to its cure might be redirected to find a cure for the common cold. *Id.*

As the *Buck* court found, reviewing a trust indenture that included the San Francisco Foundation's similarly unilateral variance power:

> Mrs. Buck knew virtually nothing about the San Francisco Foundation, its policies, practices, regulations, priorities or philanthropic philosophy. Mrs. Buck chose the San Francisco Foundation to administer the Buck Trust solely on the basis of her attorney's recommendation. Mrs. Buck did not contemplate or intend that the purposes of the Buck Trust would, at any time, be subordinate to the Foundation's.

Buck, opinion reprinted at 21 U.S.F. L. Rev. 691, 761.

4. Federal Tax Regulations Do Not Support A Broad Construction Of The Unilateral Variance Power, Especially As Regards "Undesirability"

In arguing that the unilateral variance power ought to override clearly expressed donor intent, both of the community foundation *amici*[7] supporting NYCT's position herein rely upon regulations addressing the status of community trusts, promulgated in 1976 by the Internal Revenue Service (IRS). Treas. Reg. § 1.170A-9(e). *See* Council Br. at 8; Comm. Fdn. Br. at 15-16. However, these regulations have no bearing on the proper construction of the trust instruments varied by NYCT in this case. They post-date the drafting of these instruments by many years. R. 2586-2628. The regulations implemented the provisions of the Tax Reform Act of 1969 aimed at curbing the abuses of private foundations. *Quarrie v. Commissioner of Internal Revenue*, 603 F.2d 1274, 1277 (7th Cir. 1979). The regulations only provide that donors to a publicly supported community trust (specifically defined therein) may, with respect to designated funds, benefit from the favorable tax treatment afforded public charities rather than the less favored tax treatment for private foundations, if the community trust has, *inter alia*, a form of the variance power. Treas. Reg. §§ 1.170A-9(e)(10)-(14).

Among the provisions which defeat a donor's efforts to obtain public charity tax treatment is the explicit retention of a veto power by the donor, unless required by applicable state law. Treas. Reg. § 1.170A-9(e)(11)(ii). Hence, the regulations provide -- in a form much more limited than the one NYCT asks this Court to uphold -- for a power to modify a donor's designation where "such restriction or condition becomes, in effect, *unnecessary, incapable of fulfillment, or inconsistent with the charitable needs* of the community or area served." Treas. Reg. § 1.170A-9(e)(11)(v)(B)(1)

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[7] Aligned in interest with NYCT, several community foundations, including the nation's oldest, the Cleveland Foundation, have filed a proposed brief (hereinafter "Comm. Fdn. Br." Similarly, the Council on Foundations has also submitted a proposed brief in support of NYCT ("Council Br.").

(emphasis added). All of the criteria adopted by the IRS are capable of far more objective ascertainment than the standard of "undesirability" invoked by NYCT when it varied funds away from CSS. The IRS regulations not only fail to incorporate modifications based upon desirability, they in fact emphasize more objectively verifiable criteria.

In *Quarrie v. Commissioner*, the Seventh Circuit rejected a charitable trustee's argument that his particular fund merited treatment under these same regulations' provisions for supporting organizations. Favorable tax treatment is allowed when a supporting organization benefits named public charities, so long as any substitutions for such named beneficiaries can be triggered only by events beyond the control of the supporting organization itself. 603 F.2d at 1278-9; INTERNAL REVENUE CODE § 509(a)(3); Treas. Reg. § 1.509(a)-4(d)(4)(i)(a). The language in the trust instrument in *Quarrie* was nearly identical to that of NYCT, permitting the trustee to substitute beneficiaries when the designated bequests had become "unnecessary, undesirable, impracticable, impossible or no longer adapted to the needs of the public." *Id.* at 1277. The court strongly criticized the "degree of irreducible, imprecise, subjective judgment" reflected in the "undesirability" prong of the criteria. *Id.* at 1279.

Also, the IRS regulations' treatment of state regulatory authority over community foundations strongly supports the Attorney General's contention that NYCT's discretion may be carefully circumscribed with respect to variances based upon "undesirability." The regulations expressly provide a very wide avenue for state regulation of community foundations:

> (B) Powers of modification and removal. . . . The fact that the exercise of any such power . . . is reviewable by an appropriate State authority will not preclude the community trust from [public charity treatment]. . . .
>
> (D) Inconsistent State law. (1) For purposes of [the required modification power], if a power described in such a provision is inconsistent with State law even if such power were expressly granted to the governing body by the governing instrument and were accepted without limitation under an

> instrument of transfer, then the community trust will be treated as meeting the requirements of such a provision if it meets such requirements to the fullest extent possible consistent with State law. . . (2) For example, if . . . the power to modify is inconsistent with State law, but the power to institute proceedings to modify if so expressly granted, would be consistent with State law, the community trust will be treated as meeting such requirements . . . if [it] has the power . . . to institute proceedings . . . . (3) In addition, if, for example . . . the power to modify and the power to institute proceedings to modify a condition or restriction is inconsistent with State law, but the power to cause such proceedings to be instituted would be consistent with State law, if it were expressly granted in the governing instrument and if the approval of the State Attorney General were obtained, then *the community trust will be treated as meeting such requirements . . . if [it] has the power . . . to cause such proceedings to be instituted, even if such proceedings can be instituted only with the approval of the State Attorney General.*

Treas. Reg. §§ 1.170A-9(e)(11)(v)(B) and (D) (emphasis added).

The Attorney General does not require, as did the California Attorney General in *Buck*, that all exercises of a community trust's variance power meet the substantive and procedural tests applicable to *cy pres* relief, including instituting a proceeding to obtain court approval before exercising its unilateral variance power. *See* E.P.T.L. § 8-1.1(c). It is, however, noteworthy that -- contrary to *amici's* assertion that federal tax regulations dictate NYCT's broad interpretation of its unilateral variance power (Comm. Fdn. Br. at 17) -- nowhere in the annals of the *Buck* case does it appear that the San Francisco Foundation's tax status was ever jeopardized. Rather, as set forth above, the regulations expressly contemplate significant state judicial and regulatory constraints on the unilateral variance authority. Treas. Reg. §§ 1.170A-9(e)(11)(v)(B) and (D).

Nor does the Attorney General here argue that NYCT must obtain the Attorney General's approval before it may proceed to court -- a requirement that would have been perfectly acceptable to

the IRS without in any way jeopardizing NYCT's tax status.[8] Instead, as detailed in Point I.B, *infra*, the Attorney General asserts that the NYCT must afford notice to the beneficiaries, including the Attorney General, of its intent to exercise the unilateral variance power, so that they may each consider the appropriateness of that exercise: on behalf of themselves in the case of the named beneficiaries, and on behalf of the unnamed charitable beneficiaries in the case of the Attorney General. This is especially so if the designated beneficiary cannot be given notice or is otherwise incapable of protecting its interests. The IRS regulations fully support the Attorney General's claim of such authority, and this Court should construe NYCT's unilateral variance power to mandate such notice, as the Surrogate did below in the case of the named beneficiaries. R. 17-16.

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[8] The IRS regulations further provide that a community trust will be considered not to possess the requisite modification authority where it "has grounds to exercise such a power and fails to exercise it by taking appropriate action," which the regulations expressly provide may be satisfied by "consulting with the appropriate State authority." Treas. Reg. § 1.170A-9(e)(11)(v)(E). Clearly, since the regulations do not mandate *any* consideration of desirability, the IRS is not concerned that a community trust exercise its modification power other than in the more rare circumstances of impossibility, impracticability, and the like. NYCT itself has invoked its unilateral variance power so seldomly (either before or after the 1971 actions challenged here) that it must also be presumed to concur in the Attorney General's view that the regulations are designed to address modifications triggered by highly unusual changes of circumstances. *See* R. 2172-5, 3406-7.

B. NYCT's 1971 Exercise Of Its Unilateral Variance Power Must Fail Because Of Lack Of Notice To The Attorney General

NYCT's exercise of the variance power in 1971 failed *ab initio* on the ground of failure to notify the Attorney General. On the basis of this rationale, not considered by the Surrogate, this Court should uphold the Surrogate's decision to grant an accounting. Trustees should not evade what they know to be the courts' strict interpretation of *cy pres* principles by making an extrajudicial end run around the regulatory authority of the Attorney General.

Although the Attorney General did not participate in the trial of this case below, he did present (by letter to the Surrogate) his argument concerning the singular importance of providing notice to the Attorney General "as the guardian of the ultimate charitable beneficiaries." R. 3959. NYCT did not contest the need for notice to the Attorney General in its post-trial submission following the Attorney General's letter (R. 3961-63).

Unfortunately, the Surrogate treated the Attorney General's letter as an invitation to specify "procedures for a community foundation's *factual* investigation," which it was not, and she declined to do so. R. 17-12 (emphasis added). This Court should uphold the requirement of notice to the Attorney General.

In 1993, NYCT explicitly conceded that both a beneficiary named in a donor's designation and the Attorney General as the representative for all charitable beneficiaries possess the necessary stake and authority to contest NYCT's exercise of its unilateral variance power. At that time, Samuel S. Polk, Esq., NYCT's counsel, wrote to NYCT's executive director and described an example of a variance exercised against New York Hospital, occurring (hypothetically) without a true change of circumstances. R. 3133-7. Terming such a hypothetical action an "abuse of discretion," counsel

acknowledged that both New York Hospital and the Attorney General "would have standing to bring an action against the New York Community Trust to enforce the original terms of the gift and to hold the New York Community Trust responsible for any loss of funds to New York Hospital in the interim." R. 3135.

Just as its own counsel had, the Surrogate correctly found that NYCT holds the power to control the assets held by the banks "subject to the fiduciary obligation to distribute the assets and their income in accordance with the governing instruments establishing the funds." R. 17-2. *See also* RESTATEMENT (SECOND) OF TRUSTS §§ 2, 348 (1990) (defining trust relationship and charitable trust).

Ample precedent exists under New York State case law for reading donors' charitable restrictions to establish enforceable fiduciary relationships. *St. Joseph's Hospital v. Bennett*, 281 N.Y. at 119. Similarly, New York courts have consistently affirmed the powers of the Attorney General to enforce charitable trusts on behalf of all potential beneficiaries. As noted in *In re Trust of Schlussel*, 195 Misc. 1008, 1013 (Sup. Ct. N.Y. County 1949), "[h]istorically, it has been the Attorney General's function to champion the cause of charity in the courts, and to act for named as well as indefinite beneficiaries." *Accord Grace v. Carroll*, 219 F. Supp. 270 (S.D.N.Y. 1963). The Attorney General asserts this authority as well, in support of the general public policy favoring the enforcement of donor intent. *St. Joseph's Hospital v. Bennett*, 281 N.Y. at 119 ("equity will afford protection to a donor . . . in that the Attorney General may maintain a suit"); *Alco Gravure, Inc. v. Knapp Foundation*, 64 N.Y.2d 458, 465 (1985); *In re James' Estate*, 119 N.Y.S.2d 259 (Surr. Ct. N.Y. County 1953); *In re Estate of Duffin*, 59 Misc.2d 987, 988-9 (Surr. Ct. Suffolk County 1969); *accord* RESTATEMENT (SECOND) OF TRUSTS § 361 (1990); *Carl J. Herzog Foundation, Inc. v. University of Bridgeport*, 243 Conn. 1, 10-11, 699 A.2d 995, 998 (1997) ("the theory underlying the power of the attorney general to enforce gifts for

a stated purpose is that a donor who attaches conditions to his gift has a right to have his intention enforced").

We need look no further than NYCT's own trust instrument to find a clear directive making NYCT fully accountable to the Attorney General: "[t]he Attorney General of the State of New York . . . shall have . . . the right to inspect the books, vouchers and records of the Trustees and of the Distribution Committee in anywise appertaining to said fund or the management thereof or the distribution and application of income, rents or profits thereof." R. 75.[9]

Accountability to the Attorney General on paper is meaningless if NYCT has no obligation to alert the Attorney General to so fundamental an action as the exercise of a unilateral variance power. The Attorney General urges this Court to impose notice requirements sufficient to safeguard the fundamental fairness of the extrajudicial exercise of the variance power authority. As described in Point I.A, *supra*, NYCT has over $1.5 billion in assets, distributed more than one thousand corporate and trust funds.[10] To fulfill the role which both the courts and NYCT itself have anticipated -- namely, to ensure protection of donor intent and thereby of charitable giving -- the Attorney General must be afforded a guarantee of some form of contemporaneous notice of NYCT's intention to invoke

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[9] Despite this clear reporting obligation and NYCT's counsel's concession regarding the Attorney General's right to contest the exercise of the unilateral variance power, NYCT's former executive director instructed his staff in 1971 that the Attorney General need not be consulted prior to the exercise of the unilateral variance power, and apparently never discussed the subject at all with the supposed decision makers, *i.e.*, the Distribution Committee. R. 1266-8, 3442, 3481.

[10] Even in 1971, with assets totaling just over $92 million, NYCT held 270 separate funds. R. 3729, 3739. Today, with total assets exceeding $1.5 billion, NYCT holds some 1300 individual funds. R. 2137. Thus, it is eminently reasonable to impose upon NYCT some affirmative obligation to alert the Attorney General to an intended exercise of the unilateral variance power with respect to any one of those funds.

its unilateral variance power, in sufficient time for the Attorney General to review the matter and take appropriate action where necessary.

The requirement for notice flows directly from the breadth of the Attorney General's charitable trust enforcement authority.[11] In deciding the analogous question of the Attorney General's authority to conduct discovery in a charitable trust accounting, the New York County Surrogate held:

> We cannot, at one and the same time, charge the Attorney General with the supervision of charitable trusts . . . , give him the power to see that the trust is devoted to the stated charitable purposes . . . , but deny him the opportunity to conduct an inquiry *to ascertain facts necessary for the efficient discharge of his statutory duties*.

In re Estate of Stanley, 59 Misc.2d 232, 234 (Surr. Ct. N.Y. County 1969) (citations omitted, emphasis added). Clearly, a community foundation's intention to exercise its unilateral variance power to alter the recipient of charitable trust funds is a fact necessary for the efficient exercise of the Attorney General's statutory duties to protect both donors' intent and the interests of named and unnamed beneficiaries. *Cf. In re Will of Potter*, 307 N.Y. 504, 512 (1954) (absence of notice to and participation by the Attorney General in an 1853 proceeding involving a charitable bequest held to permit the Attorney General to relitigate issues in 1954.); *see* Point II.A *infra*.

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In the analogous situation when charitable corporations seek to release restrictions after donors' deaths, they must petition the Supreme Court upon notice to the Attorney General. N.P.C.L. § 522(b). This section governs any attempt by NYCT's corporate affiliate, Community Funds Inc., to vary the terms of donors' funds lodged in its care. The Attorney General is not arguing here that NYCT was obligated affirmatively to seek judicial approval of this trust fund variance, only that NYCT should be required by this Court to provide notice to the Attorney General, as well as to the beneficiary (as the Surrogate held). The existence of a check upon NYCT's unfettered discretion should not turn on the fortuity of NYCT's or its donors' selection of the trust over the corporate vehicle. The record fails to reveal any effort by NYCT to inform donors that their choice between NYCT and Community Funds, Inc. had any legal consequences, let alone one so obviously material.

If this Court requires community trusts to provide notice of their intention to exercise a unilateral variance power, the Attorney General is readily empowered to investigate the facts sufficiently to take a position on the legitimacy of the trustees' action, in most instances without resorting to the time or expense of judicial proceedings. *See, e.g.*, E.P.T.L. § § 8-1.1, 8-1.4, EXEC. LAW § 175, N.P.C.L. § 112. A community trust might choose, as did the San Francisco Foundation, to consult the Attorney General prior to invoking the variance; another might allow the process to occur, hoping perhaps that a result acceptable to all parties (including the designated beneficiaries) would persuade the Attorney General to forego a challenge. But logically, NYCT cannot *both* argue that its discretionary exercise of the unilateral variance power is not reviewable other than for abuse *and* that it may conceal the fact of the variance from the party best suited to stand in the shoes of the donors and challenge instances of abuse.

Upon the record of this case, this Court should impose an affirmative requirement for effective notice to the Attorney General, to ensure that the basic fairness inherent in judicial *cy pres* proceedings is not absent from the unilateral variance power's extrajudicial alternative.

C. NYCT Abused Its Discretion As A Charitable Fiduciary By Misconstruing Its Power To Vary Trusts For "Undesirability"

In addition to reviewing NYCT's procedures for determining variances, the Surrogate undertook a careful review of the scope of NYCT's discretion under its trust instruments. She correctly upheld the donors' grant to a community trust of a variance power substantially broader than New York's judicial *cy pres* doctrine. R. 17-1. But her inquiry on substantive fairness did not stop there. She specifically found that NYCT had varied CSS' designated status on the basis of the "undesirable" prong of the unilateral variance power and then concluded:

> [I]nterpretation of the standard and definition of the scope of [variance power] discretion . . . requires balancing deference to the expertise of the community foundation against the expectations of donors who designate particular charitable beneficiaries. . . . Furthermore, the variance power must be broad enough to give undesirability a meaning independent of impossibility, impracticability or lack of necessity. To hold otherwise would reduce the variance power to little more than a non-judicial cy pres authority. . . . On the other hand, the standard that governs exercise of the variance power cannot be so flexible as to permit wholesale reshuffling of charitable funds without reason. . . . Defining the scope of discretion so broadly . . . would discourage rather than encourage use of community foundations.

R at 17-10 and 17-11. The Attorney General supports these findings and conclusions and urges this Court to adopt them.

The Surrogate further required that any exercise of the unilateral variance power, including one based upon undesirability, must first be grounded in an actual, objectively-determinable "change of circumstances." R. 17-11. She also correctly determined that uncertainty, without more, could not amount to undesirability:

> Change is inevitable. . . . A conclusion that uncertainty about the effect of change could justify exercise of the variance power would eliminate the obligation of the Distribution Committee to evaluate the consequences of the change. This would be a direct violation of the Resolution which requires not only a change in circumstances but one which renders continued distributions unnecessary, undesirable, impracticable or impossible.

R at 17-12 and 17-13. This holding, too, is manifestly correct.

NYCT vehemently contests the Surrogate's application of a standard requiring the Distribution Committee to find "negative" information concerning CSS before exercising the unilateral variance power. NYCT Br. 3, 22-25. The Attorney General urges this Court to articulate a slightly

different legal standard, requiring any finding of "undesirability" to turn on the intent of the original donor. However, the result is not altered: the exercise of the unilateral variance power here still fails to pass muster.

1. The Plain Meaning Of NYCT's Trust Instrument Supports The Rejection Of The Variance Power Exercise

The question of undesirability turns on evidence of the donor's views of the changed circumstances, to the extent they can be inferred from other objective information available to the Distribution Committee. That is the plain meaning of NYCT's trust instrument, as well as the consistent construction NYCT itself applied prior to 1971. As such, "the power exists in the court to see to it that there is a reasonable exercise of such discretion by the trustee." *Manning v. Sheehan*, 75 Misc. 374, 377 (Sup. Ct. Monroe County 1912). Thus, the result of applying this more logical, objective, plain meaning standard remains that the 1971 NYCT action against CSS should be rejected by this Court.

Fairly read, the plain meaning of NYCT's trust instrument's discussion of variances based upon "undesirability" is that NYCT and its donors expected such variances to be based upon the Distribution Committee's consideration of what *the original donor's* likely intent would have been had he or she been faced with present circumstances. The NYCT trust instrument is a dense, single-spaced document. R. 56-78. It is devoid of any particular emphasis or highlighting of the unilateral variance power, but the language describing the power is *immediately preceded* (in the same paragraph) by the explicit reassurance that an "expressed desire of the maker *shall be respected and observed*." R. 60 (emphasis added).

While desirability turns on a subjective inquiry, the instrument clearly intended to clothe that inquiry in some indicia of objectivity -- namely, the direction to a later Distribution Committee to

consider whether the changed circumstances would have been desirable or undesirable, not to the Committee itself or to NYCT's staff, but to that gift's originator. To find a change in a designated use undesirable, the Committee should not have to search the record for something *negative* about the beneficiary, which invites an invidious exercise fraught with potential for abuse. Rather, the Committee should look to whether or not the original donor would likely have reconsidered his or her support in light of changed circumstances. In this case, according to the Surrogate, NYCT itself considered CSS' proposed change to be positive, noting that it was "pleased to assist CSS in implementing its new directions." R. 17-14. Nevertheless, NYCT acted without finding, or even seeking, evidence that a given donor would have viewed CSS' change as undesirable.[12] Conceivably, a change could occur which a donor would have admired, but which might yet have prompted him or her to redirect the funds to a program more closely resembling the originally-funded one. Again, NYCT acted without finding or seeking such evidence. The Distribution Committee here varied the trusts on "desirability" grounds regardless of the absence of *any* relevant evidence. This action should not be condoned by this Court.

Had the Distribution Committee actually tried to discern donor intent, it would have done well to look to the plain language of the trust instruments.[13] In the Laura Spelman Rockefeller indenture,

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There was no evidence that any donors here had views on the delivery of social services from centralized offices or in the affected communities, *i.e.*, the supposed basis of CSS' "Copernican revolution" . NYCT Br. at 14-17. This was not an unknown debate at the time of the bequests, and significant evidence in the record indicates close relationships between the donors of the varied funds and CSS or its predecessors. R. 3167-75, 3185-201, 3357. Hence, assuming *arguendo* that CSS materially changed its programs in 1971, a fact which was by no means clear (R. 17-14, 17-15), NYCT plainly failed even to attempt to learn what the six funds' donors might have thought of that change.

13

Mr. William Parsons, who served as NYCT's counsel and chaired its Distribution Committee for many years (including 1971), testified that he recalled evidence of at least some donors' preferences for funding "one-on-one" services by CSS. R. 3433-4. According to his testimony, Mr. Parsons supported the exercise of the unilateral variance power based upon the mistaken belief that CSS had discontinued services to individuals. *Id.*

for example, the donor's words provided clear guidance as to what *she* might have found undesirable, both with respect to potential negative changes by the beneficiaries and other, more value-neutral changes. The indenture authorizes Distribution Committee actions (only) "to substitute other beneficiaries engaged in similar work," if the committee determines that "the quality of work performed by [the beneficiary] shall appreciably deteriorate, or if the necessity for or usefulness of the work . . . shall be substantially lessened under social conditions hereafter prevailing." R. 49-50. The Distribution Committee made no such finding.

In some instances, the Committee might find no probative evidence at all from which to draw an inference about the donor's probable thinking. On those occasions, the Committee should move beyond desirability and conclude that any variance must derive its authority from one of the other three prongs of the test, *i.e.*, necessity, impracticality or impossibility. This still would not equate the unilateral variance power with judicial *cy pres*, since the authority to redirect funds that are no longer "necessary" is broader than judicial *cy pres* in New York. Here, other than some *post hoc* attempts by counsel, NYCT did not ground its variance against CSS on any purported finding that the designated uses were unnecessary. Because it was also unquestionably possible and practical to continue distributing the income to CSS as designated, NYCT's exercise of the unilateral variance power must fail.

2. NYCT's Variance Power Guidelines and Representations To Donors Also Show That "Undesirability" Was Meant To Be Viewed Through The Eyes Of The Original Donors

In 1971, recognizing that impossibility and impracticality were self-defining conditions, NYCT's Distribution Committee promulgated guidelines for its consideration of the unilateral variance power's other two grounds, undesirability and lack of necessity. The importance of the founding donor's intent is clear on the face of those guidelines. NYCT staff were instructed to assume "that a

donor was interested in supporting the operations of a designated organization and not in contributing to its endowment." R. 2816 (first emphasis added). Staff was instructed to flag grants where "[t]he focus of operations may have moved away from the problems which interested the founder." R. 2817. Other provisions in the guidelines similarly give shape and meaning to the scope of the *necessity* inquiry. R. 2816-7. However, despite the state linkage between desirability and donor intent, the Distribution Committee made its actual variance power exercise determinations, both as to CSS and to a host of other named beneficiaries (approximately a third of all the designated beneficiaries NYCT had), based upon a host of extraneous considerations. R. 2354-7, 2819-35, 2878-83, 2907-9.

Nothing in the guidelines in any manner instructs the NYCT staff, much less any oversight authority reviewing the variance, that "undesirability" could be found based upon the contemporary views of a Distribution Committee members, independent of the donors' intent. The reason for this omission is obvious. Until challenged by CSS, NYCT did not claim so unbridled a scope of discretion.[14]

That this was so may further be inferred from the policies NYCT employed in recruiting potential donors prior to 1971, i.e., when NYCT was directed by Mr. Ralph Hayes. The Surrogate found that "[d]uring Mr. Hayes' tenure, the establishment of designated funds was encouraged." R. 17-6. The record overwhelmingly supports this holding. As noted in Point I.A.2, *supra*, NYCT recruited donors by emphasizing the opportunity to specify beneficiaries and uses. Indeed, William Parsons, chair

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As late as 1994, immediately prior to CSS' petition in this case, NYCT was *still* assuring designated fund donors that if they "wished to support specific organizations" NYCT would "make the payments as long as the 'named institutions' are in existence and fulfill the purposes *you intended*." R. 80 (emphasis added). *See also* R. 3126-7 (donor recruitment brochure from 1988 which promises, with respect to those who "choose to leave a complicated series of bequests," that NYCT's designated funds "can solve all these worries [because we] take care of the investments, regularly pay the fund's income to the charities named by the donor . . . [and if] the unexpected should occur, and a charity ceases operation, we'll be able to redirect the donor's funds.")

of the NYCT Distribution Committee, recognized that Mr. Hayes "was encouraging donors to express their wishes and *we'd carry them out.*" R. 3457 (emphasis added). NYCT described the unilateral variance power as a protection against obsolescence, as though *the only purpose* it ever had was to provide *cy pres* relief without the expense or burden of going to court. R. 2666 (explicitly terming the variance power a "*cy pres* power"); *see also* R. 126-7, 2680, 2706.[15] Thus, NYCT departed from its own guidelines and representations in determining undesirability without deference to donor intent.

3. Prior Precedent Governing Community Foundations' Variance Power Does Not Support An Expansive Reading Of NYCT's "Undesirability" Language

In the only other case squarely confronting a community foundation's effort to escape its donors' restrictions, the *Buck* court addressed an argument closely resembling the "undesirability" rationale advanced here: the claim was that a donor restriction created "inefficiencies" by compelling the community foundation to overspend in an area of relatively "less" need. The court held:

> [T]he concept of relative need . . . is not an appropriate basis for modifying the terms of a testamentary trust. . . . If it were otherwise, all charitable gifts, and the fundamental basis of philanthropy would be threatened, as there may always be more compelling "needs" to fill than the gift chosen by the testator. . . . Moreover, a standard of relative need would interpose governmental regulation on philanthropy, because courts would be required to consider questions of comparative equity, social utility, or benefit, perhaps even wisdom, and ultimately substitute their judgment or those of the trustees for those of the donors.

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15 Given NYCT's arguments concerning what it views as the potentially dire consequences of the decision below, it is significant that the relative importance of designated funds to NYCT has declined since Mr. Hayes' tenure. NYCT's next director, Mr. Herbert West, shifted the organizational emphasis to general support gifts (R. 3424-5); designated funds consequently amount today to somewhat less than 20 percent of its corpus. *See* note 2 *supra*. While even 20 percent of $1.5 billion would remain a significant fund, NYCT thus has unrestricted or much less restricted discretion over the vast majority of its holdings.

Buck, opinion reprinted at 21 U.S.F. L. Rev. 691, 751-2 n.6. *Cf. Quarrie v. Commissioner*, 603 F.2d at 1279 (criticizing similar "undesirable" language as unduly "subjective").

Where, as here, the express purpose of a unilateral variance power in the trust instrument is to avoid judicial proceedings crafted to weigh and balance the interests of all parties, *see* E.P.T.L. § 8-1.1(c)(1), this Court should not countenance NYCT's claim of such unfettered discretion, especially where NYCT's own documents provide a clear and reasonable alternative based on donors' intent. Whatever its preferences may be, NYCT obviously cannot function as a law unto itself.

4. The Surrogate Correctly Held That NYCT Abused Its Discretion In Exercising Its Unilateral Variance Power Absent Evidence Of Donors' Intent

While the record below is replete with evidence that NYCT, at least prior to 1971, enticed designated funds' donors with commitments to respect their wishes, it is completely devoid of any indication that the Distribution Committee obtained or considered any evidence of how Laura Spelman Rockefeller, Morton L. Adler, Aline S. or Netta L. Frank, Henry K.S. Williams or Linda A. Griffith would view the changed circumstances that allegedly came to pass during 1971. Under such circumstances, the Surrogate appropriately held the fiduciaries' action to be an abuse of discretion. In overturning a trustee's decision, the Court of Appeals in *Collister v. Fassitt*, 163 N.Y. 281, 290 (1900), stated that "discretion must be honestly and intelligently exercised, and if it is not, a court of equity will compel it."

Even if the Distribution Committee acted only out of the mistaken belief that it could make its own judgments on desirability, without regard to the donors' view, its decision cannot stand. Where a mistake occurs "innocently" and in good faith, it may still rise to the level of an abuse of

discretion when the trustees thus fail to effectuate the donors' intent. *In re Estate of Stillman*, Misc.2d 102, 110 (Surr. Ct. N.Y. County 1980); *In re Estate of McNab*, 163 A.D.2d 790, 793 (3d Dep't 1990). Where such a mistake involves a "[f]ailure to make reasonable investigation" -- as occurred here with respect to donor intent -- the resulting exercise of discretion will be overturned and an accounting ordered. *In re Estate of Carter*, 15 Misc.2d. 599, 601 (Surr. N.Y. County 1958). "[W]hile a court normally would not control the discretion conferred upon the trustee, it may compel him to exercise it within the bounds of reasonable judgment, and it may interpose where he fails to use his judgment because of a mistaken view, either of fact or law, as to the extent of his powers or duties." *In re Will of Kaminester*, 16 Misc.2d 1071, 1072 (Surr. Ct. Kings County 1959) (overturning a trustee's decision, citing AUSTIN WAKEMAN SCOTT & WILLIAM FRANKLIN FRATCHER, THE LAW OF TRUSTS § 187 (4th ed. 1989)).

One of NYCT's *amici* goes so far as to equate the deference owed to a community foundation's Distribution Committee with that due governmental authorities (over which, by contrast, the courts generally have review and the public has political control). Comm. Fdn. Br. at 24-25. The other proposed *amicus* argues that nothing short of "bad faith or . . . improper motive" would justify a court's decision to override the views of what it terms NYCT's "philanthropic experts and leaders." Council Br. at 15, 17. It is ironic, at best, for a "community" foundation to seek to deprive donors, beneficiaries and the community the foundation serves of the effective oversight of the foundation's actions by the community's democratic institutions, including the courts.

NYCT concedes a somewhat broader scope of review than its *amici*,[16] instead accusing the Surrogate of unduly substituting her judgment for that of its own Distribution Committee. NYCT Br. at 19-21. But courts have a clear mandate to correct trustees' good faith mistakes, particularly where the issue is donor intent. In a case where it conceded that the trustees had been "motivated by a desire to assist a worthy project," the Connecticut Supreme Court rejected their actions and held:

> It was the duty of the trustees to conform strictly to the directions which the testatrix gave. Trustees have no powers not expressly or impliedly conferred on them by the terms of the trust. . . . *Their obligation to obey the instructions of the donor of the trust is the cornerstone upon which all other duties rest.*

Conway v. Emeny, 139 Conn. 612, 620, 96 A.2d 221, 225 (1953) (emphasis added). In New York, "[t]he public policy of this State is not controlled by the actions of the charitable [trustees], whether motivated by expediency or otherwise [but rather] is aimed at the protection of the ultimate beneficiaries of the gift – the sick, the aged, the infirm or other persons who are the real objects of the charitable donation." *In re Will of Lachat*, 184 Misc. at 492.

In this case, as noted in Point I.C.2, *supra*, the chair of the Distribution Committee testified that his support for the exercise of the unilateral variance power was based upon a critical factual error about CSS' programs for such sick and infirm beneficiaries: "[h]ad I been told that CSS was continuing [one-on-one] work, I would have felt differently." R. 3433-4. Obviously, public policy compels the rejection of NYCT's trustees' exercise of the variance power under such circumstances.

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16 NYCT's current acknowledgment of the appropriateness of judicial review contrasts sharply with the instructions apparently given to its staff in 1971, to the effect that the exercise of the unilateral variance power would not be subject to judicial review. R. 1268.

The donors of the funds at issue in this case left specific instructions for the use of their funds. The fact that they may also have been aware of a unilateral variance power does not justify NYCT's ignoring, misreading or overriding the very standard for exercising a power that it had touted as a protection for donors and their chosen beneficiaries. The Surrogate thus properly found NYCT's exercise of the variance power an abuse of discretion and ordered NYCT to account.

5. NYCT's Exercise Of The Unilateral Variance Power Fails When Measured According To *Quasi Cy Pres* Standards

Finally, in reviewing NYCT's exercise of discretion here, the Court should also rely upon the judicially developed and clearly analogous *quasi cy pres* analysis set forth by the Court of Appeals in construing the N.P.C.L. The Court of Appeals construed the "substantially similar activities" standards applicable to assets distributed upon dissolution, N.P.C.L. § § 1005 (a)(3)(A) and 1008(a)(15), to encompass a broader range of fiduciary discretion than would be the case with *cy pres*. *In re Multiple Sclerosis Service Organization of New York*, 68 N.Y.2d 32 (1986). The Court cited its prior holding in *Alco Gravure v. Knapp*, 64 N.Y.2d 458, to the effect that *quasi cy pres* principles also govern N.P.C.L. § 522(b), as the standard applicable to not-for-profits' efforts to release donor restrictions on corporate assets when such restrictions become "obsolete, inappropriate, or impracticable."

The record fails to disclose any evidence of how the uses made of the restricted funds following the exercise of the unilateral variance power in any way supported the donors' goals or otherwise resembled the activities previously undertaken by CSS with such funds. NYCT did not deem itself obliged to consider such factors in reallocating such funds; it treated the varied trusts as essentially unrestricted funds. According to the chair of the NYCT Distribution Committee, the subject of the

subsequent use of varied funds never came up. R. 3442, 3481; *see also* R. 3130-2, 3145-8 (converting varied funds to the general support of health and welfare programs). NYCT thus acted improperly.

NYCT ignored unambiguous requirements in at least one of the trust instruments in question permitting reallocations only to "beneficiaries engaged in similar work." R. 50. Even before the trial of this case revealed that NYCT had vastly exceeded its discretion in choosing new beneficiaries, the following language from the Laura Spelman Rockefeller trust indenture was cited (along with the language of NYCT's Resolution and Trust) in a commentary urging stronger oversight:

> Variance power was conceptually intended to provide a quicker and less expensive version of cy pres. Clearly quite a bit has been lost in translation. The power to shift a gift from the donor's chosen beneficiary to *any charity that promotes the well being of mankind and especially the inhabitants of New York* is a power that might well be subject to regular and systematic review and oversight. Contrast this with the 800-year protection of donor intent in the courts exemplified by cy pres procedures: by definition any redirection of resources . . . is to a purpose "as close as possible" to that desired by the donor.

Suhrke, PHILANTHROPIC MONTHLY, Sept. 1995, *supra* at 11 (italics in original; additional emphasis added).

Nothing in New York precedent authorizes NYCT's claim of unfettered discretion to choose alternative beneficiaries for varied funds. The Attorney General therefore further urges this Court to require NYCT to demonstrate that the uses to which it proposes to redirect any varied funds bear an appropriate resemblance to the uses that had been deemed worthy by the original donor. *Cf. In re Multiple Sclerosis Service Org.*; *Alco Gravure v. Knapp.*

POINT II

THE ATTORNEY GENERAL IS NOT BARRED FROM OBTAINING A FULL ACCOUNTING FROM NYCT FOR THE TRUSTS AT ISSUE HEREIN

CSS, as the beneficiary of the trusts at issue, contended that the enforcement of charitable trusts according to their express terms could not be barred by the statute of limitations. R. 324-8, 1705. The Surrogate rejected that argument and applied instead the six-year statute of limitations of C.P.L.R. § 213. R. 17-16. The sole ground relied upon by the Surrogate for this holding was as follows:

> In New York, the CPLR explicitly subjects the State to statutes of limitations (CPLR 201) . . . . Applying the analogy . . . ([that an] action brought on behalf of charity is tantamount to action brought by a sovereign in the public interest) would thus lead to the conclusion that actions brought on behalf of charities in New York are subject to the statute of limitations. Since the legislature expressly subjected claims in the public interest to the statutes of limitations, judicial creation of an exception to the statutes of limitations for claims on behalf of charities would contravene the express intent of the legislature.

R. 521. In so holding, the Surrogate acted without precedential support, and incorrectly. The Surrogate also erred in limiting the accounting she decreed to a six-year period, since such limitations would apply (if at all) to the question of monetary recovery, not to the scope of the accounting itself.

In addressing the question of limitations with respect to another individual charitable beneficiary of the same trusts at issue herein, this Court relied on evidence of clear notice by NYCT to that beneficiary (not present here as to CSS and certainly not as to the Attorney General), holding:

> It is clear from documentary evidence in the record that intervenor-petitioner . . . had ample notice that . . . New York Community Trust had invoked its discretionary variance power to terminate automatic distributions . . . . [and] failed to litigate respondent's termination of the

> automatic distributions. Petitioner's present challenge to the termination of those distributions, brought considerably more than six years from its repudiation as a beneficiary, is, accordingly, time-barred.

Salvation Army v. New York Community Trust, 259 A.D.2d 289 (1st Dep't 1999).

Aside from private parties' claims on behalf of individual beneficiaries, the case law of this State does *not* reveal any clear authority supporting the Surrogate's conclusion that charitable trust enforcement by the Attorney General may be time-barred. Ample authority exists in New York and other jurisdictions declining to apply Statutes of Limitations to restrain public enforcement proceedings.

A. Limitations Will Not Bar The Enforcement Of Charitable Trusts At The Behest Of Ultimate Charitable Beneficiaries

According to the authoritative treatise on trust law, "[t]he failure on the part of the Attorney General or of an interested party to enforce [a charitable] trust does not bar its enforcement on the ground of laches or the statute of limitations." SCOTT, *supra* § 392 at 380.[17]

In a seminal case in which the Attorney General sought, based upon an intervening change in statutory authority, to enforce a charitable trust *over 100 years* after it had first been adjudicated, the Court of Appeals held that because "[t]he Attorney General . . . [was] not, apparently, represented in court" during the earlier litigation, he was "not precluded from litigating any issues" a century later. *In re Will of Potter*, 307 N.Y. at 512. *See also Grace v. Carroll*, 219 F. Supp. at 273 ("[s]o strong is New York's policy requiring the participation of the Attorney General in charitable trust

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17 Historically, absent a clearly applicable Statute of Limitations, neither time nor laches can be held to bar sovereign authority. *See* C.P.L.R. § 201, Joseph M. McLaughlin, *Practice Commentary* C201:1 (McKinney's 1990); *Magdalen College Case*, 11 Co. Rep. 66b, 74b, 77 Eng. Rep. 1235 (K.B. 1619); 1 WILLIAM BLACKSTONE COMMENTARIES *247 ("nullum tempus occurit regis").

litigation, that it has been held that he is not precluded from relitigating the issues in the New York State courts if he is not made a party to an action involving charitable trusts"). Similarly, in a closely analogous suit brought by the State "in its sovereign capacity" to recover historical artifacts, this Court flatly rejected the application of the same six-year Statute of Limitations asserted by NYCT. *State v. Vernooy*, 109 A.D.2d 682, 683 (1st Dep't 1985).

Federal courts and the courts of several states have supported the enforcement efforts of attorneys general against charitable trustees' assertions of the Statutes of Limitations. Faced with a Statute of Limitations defense interposed against the effort by the federal government, acting in its *parens patriae* capacity, to enforce a charitable trust, the District of Columbia Circuit held:

> The United States is not suing on behalf of private beneficiaries, to enforce 'a private right' . . . . This makes the suit analogous to one brought to enforce a public right, and closely analogous to one brought to enforce the right of an Indian tribe. Neither statutes of limitations nor laches apply to suits of either sort.

Mount Vernon Mortgage Corp. v. United States, 236 F.2d 724, 725 (D.C. Cir. 1956). *Cf. United States v. Florida*, 482 F.2d 205 (5th Cir. 1973) (suit to enforce title to a public park).

In rejecting Statute of Limitations and laches defenses claimed by a charitable corporation, a Virginia court noted that "courts of equity are less inclined to apply the doctrine to a charitable trust or against a government," and concluded: "[n]either the statute of limitations nor laches may be asserted as a defense in an equitable proceeding to bar the state from asserting a claim on behalf of the public." *Commonwealth v. Tauber*, 43 Va. Cir. 5, 10 (Cir. Ct. 1997).

Similarly, in upholding the charitable trust enforcement powers of the California Attorney General, the California Court of Appeals held:

> [T]he proper administration of a benevolent trust, especially the prevention of departures from legitimate objects and the redressing of breaches and repudiations of the trust, are matters of large public interest which preclude application of the doctrines of laches and estoppel and particularly so in an action brought by the attorney general. 'No length of diversion from the plain provisions of a charitable trust will prevent restoration to its true purpose.'

Brown v. Memorial Nat'l Home Foundation, 162 Cal. App.2d 513, 534, 329 P.2d 118, 131 (Ct. App. 2d Dist. 1958) (citations omitted). *Accord Mosk v. Summerland Spiritualist Association*, 225 Cal. App.2d 376, 380, 37 Cal. Rep. 366, 368 (Ct. App. 2d Dist. 1964) ("even the lapse of many years is no bar to an action by the Attorney General"); *Shattuck v. Wood Memorial Home*, 319 Mass. 444, 451, 66 N.E.2d 568, 573 (1946); *Trustees of Andover Seminary v. Visitors*, 253 Mass. 256, 299, 148 N.E. 900, 918 (1925); *William Buchanan Foundation v. Shepperd*, 283 S.W.2d 325, 336 (Tex. Civ. App. 1955), *rev'd on other grounds*, 289 S.W.2d 553 (1956).

As outlined in Point I above, public policy in New York State favors substantial deference to, and vigorous enforcement of, donor intent, particularly by the Attorney General. *Museum of the American Indian v. Board of Trustees*, 197 A.D.2d at 85; *St. Joseph's Hospital v. Bennett*, 281 N.Y. at 119. So too, that same strong policy underpinning supports the broad authority of the Attorney General to act notwithstanding the passage of time -- especially where, as here, the fiduciary claiming the shield of the Statute of Limitations (or laches) has failed to apprise the Attorney General of material actions taken with the trust, and has failed at any time to seek a voluntary judicial accounting on required notice to the Attorney General.

Having failed to undertake such a voluntary accounting of its trusts, NYCT should not be heard now to complain about later oversight. Indeed, Surrogate Preminger, an author of a leading treatise on trust law practice, has expressly identified the availability of voluntary accountings -- not the

mere passage of time -- as the true mechanism appropriate to protect trustees from stale challenges: "[t]he settlement of a [trustee's] accounting also affords . . . protection from later claims . . . for certain acts or transactions when those acts or transactions were previously disclosed in a judicially settled accounting." HON. EVE PREMINGER, ET AL., TRUSTS AND ESTATES PRACTICE IN NEW YORK, , Ch. 12 note and § 12:2 (1997).

NYCT, despite its duties as a fiduciary, not only has never accounted for these trusts, but has no voluntary accounting policy. Sound principles of trust law require NYCT to account to the Attorney General as representative of all of the unnamed, ultimate charitable beneficiaries. This Court should not allow NYCT continually to elude such accountability for its enormous charitable trust fund holdings by asserting the Statute of Limitations.

B. The Nature Of An Accounting Requires A Full Review Of The Trusts, Not A Partial, Time-Limited Review

The case presents another question of first impression, albeit not the one identified by NYCT and the community foundation *amici* concerning community foundation variance powers. This case appears to represent the first instance of a court ordering equitable relief in the form of a partial "accounting," erroneously treating the question of an accounting as one involving the Statute of Limitations, which it does not.

Initially, the Surrogate addressed the Statute of Limitations as a limitation on the potential monetary recovery available to CSS, not on the scope of the accounting itself. R. 522-23. Later, in adding text to the signed decree, she awarded relief in the nature of a partial accounting, ordering the trustees "to judicially settle their account as trustees . . . in each case for the period of October 13, 1989 to the present." R. 17.

To the extent that this decree of partial relief stemmed from the Surrogate's view of the applicability of the six-year Statute of Limitations, this Court should modify its terms. Even if proceedings *subsequent to* the accounting eventually establish a basis to limit CSS' recovery, as contrasted with any recovery the Attorney General may seek, the accounting itself must be complete.[18] An equitable accounting requires a testamentary or *inter vivos* trustee to account for its *entire* administration of the trust, from the last time it accounted -- and, if (as is the case with NYCT here) it has never done so, then from the inception of the trust. Indeed, during earlier proceedings in this case, NYCT itself conceded that it would have to account for all twenty years of its post-variance payments from the trusts at issue were it eventually to be found liable to CSS, even for a six-year period. R. 611.

This Court drew much the same conclusion in *Matter of Zilkha*, 174 A.D.2d 331 (1st Dep't 1991), ordering a trustee to account for a period of nearly twenty years, back to 1973, the date of a prior judicial settlement of the same account. A "partial" accounting establishes nothing, if only because any opening balance that is declared in such an accounting, by definition, is entirely arbitrary.

In this case, sorting out the accounting relief from the Statute of Limitations issue is further complicated by NYCT's conduct in making the exercise of the unilateral variance power known, *i.e.*, in "repudiating" the trust relationship with the named beneficiaries. The Surrogate correctly held that no Statute of Limitations would begin to run against CSS unless and until NYCT had "openly repudiated" its obligation to CSS, within the meaning of *In re Barabash*, 31 N.Y.2d 76, 80 (1972). R. 17-16. The Surrogate also correctly found, upon the factual record at trial, that NYCT's "mixed

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[18] Even assuming that *some* basis may exist to limit monetary recoveries by CSS, such recoveries cannot be fully determined until all parties to the accounting have had an opportunity to review the full documentation of the trustees' receipts and disbursements throughout the trusts' administration. *Cf.* N. Y. SURR. CT. PROC. ACT ("S.C.P.A.") §§ 2209, 2211.

signals" to CSS "muddied the message of an otherwise clear repudiation, and thus there was no effective repudiation." *Id.* Notwithstanding these correct factual conclusions and citation of the correct legal authority, the Surrogate arrived at an incorrect legal conclusion, holding that the Statute of Limitations had commenced running as to CSS. This is contrary to the *Barabash* holding.[19]

This Court rejected exactly such an approach many years earlier, holding that, whatever the ultimate liability may be once the accounting is completed, even in the private (non-charitable) context the full and complete accounting should be granted:

> A person obtaining possession of property as [a fiduciary] should not be permitted to acquire title thereto by failure of those interested to require him to account unless there is no avenue of escape from such an inequitable result. If there be any doubt about the facts the far better practice is to grant the order. . . . *The application of the Statute of Limitations may then be determined more satisfactorily when it is sought to enforce some right based on the accounting.*

In re Estate of Meyer, 98 A.D. 7, 9 (1st Dep't 1904), *aff'd*, 181 N.Y. 553 (1905) (emphasis added).

Based upon *Meyer*, the court below should have decreed an accounting from NYCT for the entire span of the CSS trusts, and only *then* considered if it was appropriate to limit either CSS' ultimate ability to recover lost funds or the Attorney General's ultimate enforcement authority over any wrongful exercises of the unilateral variance power, improper expenditures or other defects. As Surrogate Preminger has written, an accounting affords "an opportunity to review the record . . . to determine whether the [trustee] has properly administered the [trust] and whether any action need be taken to protect the beneficiary's interest." PREMINGER, *supra* § 12:2.

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19 In addition to the finding that there was never a complete repudiation as to CSS, this Court can take notice that there has never been so much as a claim of notice (much less repudiation) to the Attorney General. Hence, *Barabash* plainly does not support any contention that the Statute of Limitations precludes the Attorney General's assertions on behalf of unnamed, ultimate charitable beneficiaries. 31 N.Y.2d at 80.

CONCLUSION

For the foregoing reasons, the Attorney General urges this Court to uphold the result below, modifying the Surrogate's opinion and decree to require that: (1) in exercising its unilateral variance power, NYCT must provide notice to the Attorney General; (2) in so exercising its variance power, NYCT must evaluate the criterion of "undesirability" only in the light of the original donor's intent for the funds at issue; (3) the enforcement of a charitable trust by the Attorney General, acting on behalf of the trust's unnamed, ultimate charitable beneficiaries, is not barred by any limitations of action; and (4) NYCT must account for its administration of the six trusts at issue from their inception.

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Respectfully submitted,

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