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# Case for A.U. (Accountable Universities): Enforcing University Administrator Fiduciary Duties through Student Derivative Suits


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**Abstract**

This Comment examines issues of charitable fiduciary enforcement in the context of private universities. Part I reviews the law of charitable entities, the rationale behind attorney general charitable enforcement, and the failures of that enforcement regime. It also examines generally the private charitable enforcement options of special interest standing and nonprofit member derivative suits. Part II examines these issues in the context of the private university, and details why student attempts to enforce the fiduciary duties of university administrators under the special interest doctrine have failed. Part III argues for the judicial recognition of a university student derivative cause of action under the precedent of Stern v. Lucy Webb Hayes National Training School. Because university students are analogous to nonprofit corporation members and allow them to bring derivative suits to enforce the fiduciary duties that university presidents and trustees owe to the school.

**Keywords**

Non-profit corporation, Private university, Charitable organization, Fiduciary duties, Enforcement, Governance

# COMMENTS

# THE CASE FOR A.U. (ACCOUNTABLE UNIVERSITIES): ENFORCING UNIVERSITY ADMINISTRATOR FIDUCIARY DUTIES THROUGH STUDENT DERIVATIVE SUITS

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## INTRODUCTION

The public craze for corporate accountability[1] has sparked a recent debate over the state of nonprofit governance and charitable accountability.[2] Despite varying suggestions for reform,[3] scholars

1. Public demand for corporate accountability reached its height after the Enron scandal in 2001, which led to the creation of the largest federal corporate reform in decades, the Sarbanes-Oxley Act of 2002. *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002); *see also* Sherry Castle Whitley, *Sarbanes-Oxley Act of 2002: A Primer on Reformed Corporate Accountability*, 56 CONSUMER FIN. L.Q. REP. 236 (2002) (outlining the provisions of the Sarbanes-Oxley Act and describing the legislature's intent to curtail recent failures in corporate accountability).

2. The *Chicago-Kent Law Review* dedicated its 2005 symposium entirely to the subject of nonprofit and charitable enforcement. The symposium papers are an excellent background source on issues related to this Comment. *See generally* Symposium, *Who Guards the Guardians?: Monitoring and Enforcement of Charity Governance*, 80 CHI.-KENT L. REV. 543 (2005) (providing an extensive overview of the issues of nonprofit governance).

3. *See, e.g.*, Evelyn Brody, *Institutional Dissonance in the Nonprofit Sector*, 41 VILL. L. REV. 433, 504 (1996) [hereinafter Brody, *Institutional Dissonance*] (urging increased attorney general funding specifically for charity enforcement); Milton Cerny &

agree that the current "sad state"[4] of charitable enforcement is inadequate[5] and "more theoretical than real."[6] Accounts of university presidents who receive excessive compensation, misappropriate school funds for personal use, and questionably manage school assets provide particularly disturbing examples of failed charitable enforcement.[7] In particular, recent allegations against Benjamin Ladner, former president of American University, cast doubts on whether universities are putting education first.[8]

After serving as president of American University for eleven years, Benjamin Ladner was dismissed in October 2005 after a months-long investigation by university trustees into his spending of university funds.[9] Anonymous tips and increased press attention spurred trustees to review Ladner's expenses, such as first class travel, extravagant family meals, use of university staff for personal errands, and lavish expenditures on liquor and entertainment—including

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Catherine E. Livingston, *IRS Intermediate Sanctions: How They Will Impact Colleges and Universities*, 25 J. COLL. & UNIV. L. 865, 865-67 (1999) (discussing the possibility of IRS enforcement through revocation of federal tax-exempt status and intermediate tax penalties against abusive charities); Harvey J. Goldschmid, *The Fiduciary Duties of Nonprofit Directors and Officers: Paradoxes, Problems, and Proposed Reforms*, 23 J. CORP. L. 631, 637-38 (1997-98) (suggesting expanded use of private charitable enforcement); Kenneth L. Karst, *The Efficiency of the Charitable Dollar: An Unfulfilled State Responsibility*, 71 HARV. L. REV. 433, 476-83 (1960) (proposing the creation of state nonprofit oversight agencies to regulate the use of charitable contributions and investigate cases of nonprofit abuse); Dana Brakman Reiser, *There Ought To Be a Law: The Disclosure Focus of Recent Legislative Proposals for Nonprofit Reform*, 80 CHI.-KENT L. REV. 559, 568-80 (2005) [hereinafter Reiser, *There Ought to Be a Law*] (highlighting recent reforms in New York and Massachusetts which focus on increased disclosure and nonprofit self-regulation). For a brief and thorough review of suggestions for charitable enforcement reform, see MARION R. FREMONT-SMITH, GOVERNING NONPROFIT ORGANIZATIONS: FEDERAL AND STATE LAW AND REGULATION 336-38 (Harvard Univ. Press 2004). *See also infra* Part II.C (discussing charitable enforcement reform in greater detail).

4. Henry B. Hansmann, *Reforming Nonprofit Corporation Law*, 129 U. PA. L. REV. 497, 601 (1981) (hypothesizing that a relaxed social attitude towards nonprofits has perpetuated lenient enforcement efforts by state authorities).

5. Karst, *supra* note 3, at 437 (describing attorney general charitable enforcement as "irregular and infrequent").

6. Iris J. Goodwin, *Donor Standing To Enforce Charitable Gifts: Civil Society vs. Donor Empowerment*, 58 VAND. L. REV. 1093, 1138 (2005); *see also* Paul G. Haskell, *The University as Trustee*, 17 GA. L. REV. 1, 24 (1982) ("[N]o one now exercises general oversight of the activities of private universities.").

7. *See* Alec Macgillis, *The Princely Habits of College Presidents*, BALT. SUN, Oct. 2, 2005, at 1F (detailing four recent university presidential spending scandals, including Benjamin Ladner of American University in 2005, Gregory O'Brien of the University of New Orleans in 2003, Mark Perkins of Towson University in 2002, and Peter Diamandopoulos of Adelphi University in 1997).

8. *See* Editorial, *Fired in Style*, RICH. TIMES DISPATCH (Va.), Nov. 30, 2005, at A10 ("Ladner fattened his lifestyle, and now his pockets, with money diverted directly from the school's academic programs.").

9. *See generally* Jean Marie Angelo, *Spending Debacle Undoes University President*, UNIV. BUS., Nov. 1, 2005.

spending on an engagement party for his son.[10] All told, it is suspected that Ladner misused more than $500,000 of the university's funds between 2002 and 2005.[11]

The university community received another shock in November 2005, when the American University Board of Trustees agreed to dismiss Ladner with a severance package valued at $3.7 million.[12] In addition to angering the university community and making headlines, the Ladner scandal also made history. In December 2005, for the first time on record, the U.S. Senate Finance Committee launched an investigation into the governance and operations of a private university.[13]

Occurring less than ten years after a similar scandal at Adelphi University,[14] the Ladner scandal exposes a need for a critical examination of the unique problems of fiduciary and charitable enforcement in the private university setting.[15] While scholars have noted the lack of accountability in the nonprofit sector for nearly fifty years,[16] few have questioned whether the justification for attorney

10. Lois Romano, *AU Scandal Atypical in Post-Enron Era, College Presidents Say*, WASH. POST, Oct. 10, 2005, at A18; Macgillis, *supra* note 7.

11. Michael Janofsky, *American U. Dismisses Its President Over Spending*, N.Y. TIMES, Oct. 11, 2005, at A14; Macgillis, *supra* note 7.

12. *See Fired in Style*, *supra* note 8 (scoffing at American University's decision to hand Ladner a "golden parachute," and arguing that he should have been fired for cause).

13. *See* Alan Finder, *Senate Panel to Review American U. Board's Actions on Spending*, N.Y. TIMES, Dec. 3, 2005, at A20 (discussing Senator Charles Grassley's decision to investigate whether the American University Board of Trustees acted properly in handling the Ladner investigation and dismissal).

14. In the mid 1990s, Adelphi University President Peter Diamondopoulis and eighteen Adelphi University trustees were removed from their positions amid allegations of excessive compensation and waste of school assets. *See* Evelyn Brody, *The Limits of Charity Fiduciary Law*, 57 MD. L. REV. 1400, 1401-02 (1998) [hereinafter Brody, *Limits of Fiduciary Law*] (providing information and background on the Adelphi University scandal); Bruce Lambert, *New York Regents Oust 18 Trustees from Adelphi U.*, N.Y. TIMES, Feb. 11, 1997, at A1 (discussing Adelphi University's attempts to recruit new trustees in the wake of the scandal); *see also* MacGillis, *supra* note 7 (discussing four recent scandals by university presidents).

15. *See* Robert Steele Jr., Letter to the Editor, *American University: College or Corporation?*, WASH. TIMES (Wash., D.C.), Oct. 16, 2005, at B02 (emphasizing how modern university presidents resemble corporate executives, and urging universities to examine the Ladner case to avoid creating similar "administrative monsters").

16. Publication of *The Charitable Dollar* in 1960 sparked debate over nonprofit accountability, the effectiveness of attorney general enforcement, the proper regulation of nonprofit entities, and the costs and benefits of proposed reforms. *See generally* Karst, *supra* note 3, at 435-68 (providing a broad overview of legal mechanisms available to enforce charitable fiduciaries in the 1960s). Soon thereafter, California and New York responded by enacting separate statutes to govern nonprofit corporations, which served as templates for the American Law Institute's ("ALI") Model and Revised Model Nonprofit Corporation Acts. *See* REVISED MODEL NONPROFIT CORP. ACT (1987); MODEL NONPROFIT CORP. ACT (1964); *see also* CAL. CORP. CODE § 5000 (West 2006) (creating provisions of law applicable to

general enforcement applies equally to private universities.[17] Fewer still have explored the historical treatment of student enforcement attempts or critically examined students' alternative enforcement options.[18]

Each year approximately 3.8 million students attend private colleges in the United States[19] and place $69 billion in the hands of university trustees.[20] These sizable figures, combined with ineffective attorney general enforcement and recurring university scandals, hint at a looming problem in higher education. At a minimum, they call for a critical analysis of current university fiduciary enforcement by the attorneys general and exploration of the alternative private enforcement mechanisms available to students.

This Comment examines issues of charitable fiduciary enforcement in the context of private universities. Part I reviews the law of charitable entities, the rationale behind attorney general charitable enforcement, and the failures of that enforcement regime. It also examines generally the private charitable enforcement options of special interest standing and nonprofit member derivative suits. Part II examines these issues in the context of the private university, and details why student attempts to enforce the fiduciary duties of

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corporations formed for public or charitable purposes); FREMONT-SMITH, *supra* note 3, at 52 (relaying the origins of the Model Nonprofit Corporation Act in the California act). Today, nearly all states have codified some version of the ALI's Model Acts, and a line of jurisprudence unique to nonprofit organizations has begun to develop. *See id.* at 152 app. tbl.3 (cataloging each state's nonprofit corporation law and describing its relation to the Revised Model Nonprofit Corporation Act).

17. *See* Karst, *supra* note 3, at 434 (stressing the need to conserve charitable funds for public service purposes through efficient enforcement methods); *see also infra* Part I.B (explaining that the benefits of exclusive attorney general enforcement consistently outweigh the costs of enforcement alternatives for the nonprofit sector generally by protecting charities from vexatious and frivolous private litigation with uninterested parties).

18. The most comprehensive examination of the issue of standing in cases where university students challenge administrator decisions and conduct considers only the historical treatment of students under the special interest doctrine of charitable trust enforcement. *See* Mary Grace Blasko, Curt S. Crossley & David Lloyd, *Standing to Sue in the Charitable Sector*, 28 U.S.F. L. REV. 37, 64-65 & 72-74 (1993) (reviewing cases in which students sought injunctive relief or damages from school administrators).

19. NATIONAL CENTER FOR EDUCATION STATISTICS, DIGEST OF EDUCATION STATISTICS, ch. 3 (2004), http://nces.ed.gov/programs/digest/d04/tables/dt04_338.asp (last visited July 27, 2006) [hereinafter EDUCATION STATISTICS].

20. This figure is the average annual tuition paid per private university student (approximately $18,000) multiplied by the number of students enrolled each year in private universities (approximately 3.85 million), which totals approximately $69.3 billion in annual private university tuition paid. *See id.* (listing enrollment figures); John Boehner, House Education & Workforce Committee, *Fact Sheet: The Skyrocketing Cost of Higher Education*, 2003 HOUSE EDUC. & WORKFORCE COMMITTEE, at 1, *available at* http://edworkforce.house.gov/issues/108th/education/highereducation/factsheetcost101003.htm [hereinafter *Skyrocketing Cost of Higher Education*] (providing tuition statistics).

university administrators under the special interest doctrine have failed. Part III argues for the judicial recognition of a university student derivative cause of action under the precedent of *Stern v. Lucy Webb Hayes National Training School.* Because university students are analogous to nonprofit corporation members and allow them to bring derivative suits to enforce the fiduciary duties that university presidents and trustees owe to the school.

## I. THE FORM AND ENFORCEMENT OF CHARITABLE ENTITIES

The concept of a university student derivative suit is, at first glance, deceptively simple. Students, as the primary beneficiaries of private university services, are the most logical and natural constituency for holding university leaders accountable. However, the law of charitable institutions, which is derived from both trust and corporate principles, greatly complicates the ability of students to bring these enforcement actions. Therefore, a brief primer on charitable institutions and enforcement is in order.

### *A. The Legal Forms of Charitable Entities: Charitable Trusts and Nonprofit Corporations*

In the United States, two forms of legal entity are available for accomplishing charitable work—the charitable trust and the nonprofit corporation.[21]

#### *1. Charitable trust*

The charitable trust is the original charitable form in the United States.[22] Like a private trust,[23] a charitable trust divides the rights to manage and use trust property between the charitable trustee and a charitable beneficiary.[24] By separating these rights, private and

21. *See* Evelyn Brody, *Charity Governance: What's Trust Law Got to Do with It?*, 80 CHI.-KENT L. REV. 641, 646 (2005) [hereinafter Brody, *Charity Governance*] (discussing the legal consequences of choosing a nonprofit corporation and a charitable trust).

22. *See* FREMONT-SMITH, *supra* note 3, at 43-48 (explaining that early American colonists adopted the legal form of the charitable trust and its corresponding common law because it was the preferred form for charities in England at the time).

23. In a private trust, the trustee retains legal title and control of the trust property while the beneficiary retains the right to use and enjoy that property. Brody, *Limits of Fiduciary Law, supra* note 14, at 1419. Since the beneficiary bears the economic risk of property ownership, he retains an automatic legal right to oversee trustees' property management and enforce trustee fiduciary duties in courts of law. *See id.* at 1420 (describing the trustee's duty of loyalty and discussing potential legal consequences for a breach in this duty).

24. The power to manage, control, and make decisions regarding charitable trust property is placed in the hands of a charitable trustee. *See id.* at 1421 (discussing the strict fiduciary standard applied to charitable trustees). A charitable beneficiary is a member of the class of persons intended by the grantor to receive the benefits, use,

charitable trusts create incentives for trustees to prioritize their own interests over those of the beneficiary.[25] To combat this agency problem,[26] the law imposes the strictest duties of loyalty, care, fair dealing, and obedience on trustees as they manage trust property.[27]

The charitable trust differs from the private trust because it gives rise to a different form of beneficial interest.[28] A charitable trust benefits a recognized cause or purpose instead of an individually named beneficiary.[29] Because charitable trusts benefit social purposes or meet needs that are otherwise public responsibility, they save society the cost of that charitable function.[30] Consequently, the general public is the "true" beneficiary of the charitable trust.[31] The

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and enjoyment of the property. *See* Robert A. Katz, *Let Charitable Directors Direct: Why Trust Law Should Not Curb Board Discretion Over a Charitable Corporation's Mission and Unrestricted Assets*, 80 CHI.-KENT L. REV. 689, 709 (2005) (explaining that a charitable trust's ultimate beneficiaries are "the public or the community at large").

25. Neither private nor charitable trustees bear the economic risk of property devaluation; therefore, they are more willing to take unreasonable investment risks or engage in self-dealing transactions to maximize their personal gain from the relationship. *See id.* at 710 ("[A] charitable trust's trustees may be tempted to diverge from the settlor's instructions in order to generate what they believe is a greater benefit for the beneficiaries (i.e., the public) or to advance their own idiosyncratic objectives.").

26. *See id.* at 705-06 (explaining that the "usual agency problem" created by a separation of management and risk results in a conflict between the trustee's self-interest and the interests of the beneficiaries).

27. *See* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 92 (1991) ("Socially optimal fiduciary rules . . . preserve the gains resulting from the separation of management from risk bearing while limiting the ability of managers to give priority to their own interests over those of investors.").

28. *See* FREMONT-SMITH, *supra* note 3, at 127-28 (distinguishing private and charitable trusts by the recipient of the benefit provided); *see also* RESTATEMENT (SECOND) OF TRUSTS § 348 (1959) (eliminating any reference to a beneficiary from the definition of a charitable trust, and requiring only the existence of a fiduciary charged with using the property for a specific charitable purpose).

29. *See* Brody, *Limits of Fiduciary Law*, *supra* note 14, at 1421 (contrasting private trusts, which name specific beneficiaries, with charitable trusts, which create indefinite beneficiaries); Katz, *supra* note 24, at 709 ("Whereas a private trust must benefit identified or identifiable individuals . . . a charitable trust can confer benefits directly upon members of an indefinite class of persons . . . ."); RESTATEMENT (SECOND) OF TRUSTS § 348 (explaining that a charitable trust subjects "the person by whom the property is held to equitable duties to deal with the property for a charitable purpose"). For example, where a private trust would name the grantor's elderly spouse as the beneficiary, a charitable trust would dedicate property to the purpose of supporting elderly widows. *See* Hooker v. Edes Home, 579 A.2d 608 (D.C. 1990) (holding that a donation made to create and maintain a home for elderly, low-income Georgetown widows created a charitable trust).

30. Charities fill a quasi-governmental role by providing services for which the government would otherwise be responsible. Blasko ET AL., *supra* note 18, at 37. Thus, the state has an interest in promoting efficiency in the charitable sector to further charitable goals and meet public needs. *See* Karst, *supra* note 3, at 437-38 (discussing the public sector's "paramount interest" in the disposition of money designated for private charity).

31. *See* FREMONT-SMITH, *supra* note 3, at 127 (explaining how the indefinite beneficiary requirement for charitable trusts places the true benefit of the charity in

individual recipients of charitable aid are secondary beneficiaries who enjoy only an indefinite or indirect legal interest in the charity.[32]

*2. Nonprofit corporation*

The nonprofit corporation is the most common and popular charitable form in America[33] and borrows key characteristics from both trust and corporate entities.[34] For instance, like charitable trusts, nonprofit corporations typically serve eleemosynary, or charitable, purposes.[35] Thus, the principles of charitable trust law often apply to cases involving nonprofit corporations.[36] Like business corporations, nonprofit corporations are formed under state incorporation laws,[37] have organizational structures similar to for-profit corporations,[38] and share property ownership rights and perpetual existence separate from their managers and members.[39]

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the public sector).

32. *See id.* at 128 (describing secondary charitable trusts' beneficiaries, those who actually receive aid, as mere "'conduits of the social benefits to the public'" (quoting GEORGE G. BOGERT & GEORGE T. BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 362 (3d ed. 1977))).

33. *See generally* James J. Fishman, *The Development of Nonprofit Corporation Law and an Agenda For Reform*, 34 EMORY L.J. 617, 629-37 (1985) (tracing the development of the nonprofit corporation in the United States, and explaining the American preference for the corporate form as a reaction to the success, ease of formation, and acceptance of the business corporation by American society and government).

34. *See infra* notes 36-51 and accompanying text (discussing the basic principles of nonprofit corporation law).

35. For example, both the United Way of America and the American Red Cross are organized as nonprofit corporations to accomplish community development and disaster relief, which are traditionally recognized charitable purposes. *See* American Red Cross, http://www.redcross.org/aboutus (last visited July 16, 2006) (emphasizing its commitment to domestic and international relief and development); United Way, http://national.unitedway.org/ourwork/index.cfm (last visited July 16, 2006) (highlighting its work in community and economic development).

36. *See* Brody, *Charity Governance*, *supra* note 21, at 648 (discussing the general convergence of corporate and trust doctrines in the law of charities, but noting several important distinctions such as fiduciary standards and use of restricted donations).

37. In a minority of states (Delaware and Kansas), nonprofit organizations incorporate under the same enabling statute as business corporations, but include restrictive charitable purpose and profit-seeking clauses in the charity's articles of incorporation. FREMONT-SMITH, *supra* note 3, at 152. In the majority of states, which recognize important distinctions between for-profit and nonprofit entities, separate nonprofit corporation codes exist for nonprofit incorporation. *See id.* at 152, app. tbl.3 (discussing the available modes of incorporation among the states and listing the applicable incorporation statutes for each state). These nonprofit corporation codes are often modeled after the Revised Model Nonprofit Corporation Act of 1987 ("RMNCA"). *Id.*

38. Both for-profit and nonprofit corporations use the split-control governance structure, which consists of a board of directors that broadly governs the mission and direction of the organization, as well as officers and managers who oversee daily operations. *See* REVISED MODEL NONPROFIT CORP. ACT §§ 8.01(a), 8.40(a) (1987) (requiring each nonprofit corporation to have a board of directors and providing

Nonprofit corporations differ from their business counterparts in two key respects. First, nonprofit corporations can exist with or without shareholders or members.[40] Second, although nonprofit corporations are allowed to collect profits from sales of merchandise or services, they are strictly prohibited from making distributions of those profits to their members.[41]

Those nonprofit corporations that do recognize members generally organize for the common benefit of their members, or provide members with products or services otherwise unavailable in the market.[42] Common examples include social clubs, political interest groups, consumer federations, and trade associations.[43] These members share some similar rights and privileges as corporate shareholders. Nonprofit members may exercise some control of the organization through voting[44] or derivative litigation.[45] Membership

default offices of president, secretary, and treasurer).

39. *See, e.g.*, Trustees of Dartmouth Coll. v. Woodward, 17 U.S. (4 Wheat.) 518, 636 (1819) (explaining how incorporation enables groups of individuals to accomplish common goals through one entity that can "manage its own affairs, and . . . hold property, without the perplexing intricacies . . . of perpetual conveyances").

40. The RMNCA gives nonprofit corporations the option of creating classes of members in the organization. *See* REVISED MODEL NONPROFIT CORP. ACT § 6.01(a) ("[A nonprofit corporation] *may* establish criteria . . . for the admission of members.") (emphasis added). These individuals resemble shareholders because they have voting rights, often make donations or pay membership fees, and have the right to bring derivative actions on behalf of the corporation. *Id.* §§ 1.40(21), 6.30.

41. *See* REVISED MODEL NONPROFIT CORP. ACT §§ 13.01, 13.02 (prohibiting public benefit and religious corporations from distributing monetary earnings to members, but allowing these corporations to earn sufficient profits to support their continued operation); James J. Fishman, *Improving Charitable Accountability*, 62 MD. L. REV. 218, 225-26 (2003) (discussing how the nondistribution constraint of a nonprofit corporation distinguishes it from a business corporation).

42. *See* Avner Ben-Ner, *Who Benefits from the Nonprofit Sector? Reforming Law and Public Policy Towards Nonprofit Organizations*, 104 YALE L.J. 731, 733-34 (1994) (explaining that a large percentage of nonprofit corporations exist to meet the needs of its members where the market has failed to do so); *cf.* Hansmann, *supra* note 4, at 502-04 (discussing the reasons why nonprofit incorporators choose the member or nonmember structure, focusing particularly on the goals of the organization and whether the primary focus of the nonprofit corporation is to benefit the general public or the members themselves).

43. *See* Hansmann, *supra* note 4, at 502-03 (listing examples of different types of donative, commercial, mutual and entrepreneurial nonprofits).

44. Voting rights normally entitle members to a voice in the amendment of the articles of incorporation and the right to elect directors. *See* REVISED MODEL NONPROFIT CORP. ACT §§ 1.40(21), 6.01 (defining "members" as those who have the right to vote for directors of the organization, but granting nonprofit incorporators great flexibility in structuring and defining member classes).

45. *See id.* § 6.30 (establishing the statutory right of members to bring derivative suits in place of the nonprofit corporation when certain conditions have been met); *see also* Bourne v. Williams, 633 S.W.2d 469, 471-72 (Tenn. Ct. App. 1981) (recognizing the common law right of nonprofit members to bring derivative suits).

dues often serve as the corporation's main source of income,[46] but dues are not a prerequisite to membership.[47] Most importantly, members participate, are committed to, and are continually interested in the goals, purposes, and operations of the organization.[48]

Nonmember nonprofits do not recognize a voting member class, but leave organizational control entirely in the hands of a self-perpetuating board of directors.[49] Nonmember nonprofits usually provide services for a broad or loosely defined class of beneficiaries, and therefore are more likely to rely on donations or product sales for operating income.[50] Examples of nonmember nonprofits include prototypical charities like the United Way, the Red Cross, and public service providers such as hospitals.[51]

### *B. Charitable Enforcement Under the Attorney General*

Despite the distinctions between charitable trusts and nonprofit corporations,[52] enforcement of their missions and fiduciary duties is

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46. Nonprofit membership dues may be analogous in some situations to the purchase price of corporate shares. In both cases, shareholders or nonprofit members give something of value (money, time, or commitment) in exchange for privileges associated with the organization (for shareholders, the privilege of sharing profits, and for members, the privileges of membership and involvement). *Cf.* Brenda Boykin, *The Nonprofit Corporation in North Carolina: Recognizing a Right to Member Derivative Suits*, 63 N.C. L. REV. 999, 1012 (1985) (explaining that while a member of a nonprofit corporation does not have an equity interest, he or she may have a pecuniary interest because membership is generally contingent on the payment of dues).

47. *Compare* REVISED MODEL NONPROFIT CORP. ACT § 6.02 ("Except as provided in its articles or bylaws, a corporation may admit members for no consideration or for such consideration as is determined by the board."), *with* REVISED MODEL BUSINESS CORP. ACT § 6.21(b) (2002) ("The board of directors may authorize shares to be issued for consideration consisting of any tangible or intangible property or benefit to the corporation, including cash, promissory notes, services performed, contracts for services to be performed, or other securities . . . .").

48. *See* Lizabeth A. Moody, *The Who, What, and How of the Revised Model Nonprofit Corporation Act*, 16 N. KY. L. REV. 251, 270-71 (1989) (emphasizing that the membership provisions under the RMNCA were designed to reflect members' governing and functional—not financial—roles in the organization).

49. *See* Hansmann, *supra* note 4, at 502 (explaining that if an organization does not have members, then an autonomous board is vested with the responsibility of electing a director and voting on other fundamental issues).

50. *See id.* (distinguishing between donative nonprofits, which rely on unrestricted donations for income, and commercial nonprofits, which obtain most of their income from prices charged for goods and services).

51. *Id.* at 502-03.

52. *See* Brody, *Charity Governance*, *supra* note 21, at 648 (highlighting two substantive legal differences between the trust and corporate charitable forms: applicable fiduciary standards and powers of trustees and directors). Generally speaking, charitable trustees are held to stricter fiduciary standards of loyalty and care than nonprofit directors. *Id.*; *see also* Stern v. Lucy Webb Hayes Nat'l Training

accomplished in the same manner.[53] Since the general public is the primary beneficiary of both charitable forms,[54] enforcement authority rests primarily with the attorney general as representative of the public interest.[55] Individual members of the public generally do not have standing to enforce charitable purposes or fiduciary duties, or to challenge the management of charitable assets.[56]

Several policy considerations support the system of attorney general enforcement. In practical terms, it is difficult to identify

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Sch. for Deaconesses & Missionaries (Stern II), 381 F. Supp. 1003, 1013 (D.C. Cir. 1974) (applying corporate standards of management, not trust standards, when judging the validity of nonprofit directors' actions). Nonprofit directors also generally have greater decision-making flexibility in administrative matters, amendment of the corporate articles, and merger or dissolution decisions. *See* FREMONT-SMITH, *supra* note 3, at 155-58 (discussing the flexible means of nonprofit management, amendment, and asset reallocation under the RMNCA and other state nonprofit corporation codes). Meanwhile, courts retain a quasi-supervisory role over trust management under the doctrines of *cy pres* and deviation, which limit the power of charitable trustees to dissolve or reallocate trust assets to new or expanded purposes. *Id.* at 173-86; *cf.* RESTATEMENT (SECOND) OF TRUSTS § 348, cmt. f (1959) (discussing charitable directors' elevated control in using donations due to the lack of the *cy pres* doctrine in charitable corporate law).

53. The rules governing the enforcement of charitable trusts apply equally to charitable corporations. *See, e.g.*, Holt v. Coll. Osteopathic Physicians & Surgeons, 394 P.2d 932, 937 (Cal. 1964) (applying the law of charitable trust enforcement to allow the "trustees" of a charitable corporation to bring suit); RESTATEMENT (SECOND) OF TRUSTS § 348, cmt. f ("Ordinarily the principles and rules applicable to charitable trusts are applicable to charitable corporations."). The rationale behind this rule is clear: incorporation offers charities a number of advantages including limited liability and flexibility in governance and decision-making. *See supra* note 52 and accompanying text (outlining the advantages and flexibility under the nonprofit corporate form). If courts applied vastly different legal standards to similar charitable entities, an incentive would exist for trustees to incorporate in order to circumvent donors' intentions in managing trust property. Applying different standards and creating opportunities for disregard of donor intent would thwart the policy goal of encouraging philanthropy. Therefore, the trust laws governing charitable enforcement must be applied to all organizations receiving donations, regardless of their form of governance.

54. *See supra* notes 31-32 and accompanying text (explaining why the general public is the primary beneficiary of work done for charitable purposes).

55. In most states, the power of the attorney general has been enacted by statute. *See, e.g.*, REVISED MODEL NONPROFIT CORP. ACT § 1.70 (1987) (empowering the attorney general to institute or intervene in any action involving a nonprofit corporation). In the few states where the legislature has remained silent on the issue of charitable enforcement, the courts have derived the attorney general's enforcement power from its executive *parens patriae* role in society. *See* FREMONT-SMITH, *supra* note 3, at 301, 305-06.

56. Most private parties are barred by restrictive standing rules from filing enforcement suits against charities. *See* Alco Gravure, Inc. v. Knapp Found., 479 N.E.2d 752, 755 (N.Y. 1985) (finding that the "general rule" of charitable enforcement under New York law excluded charitable beneficiaries from bring suit against a charity); *see also* FREMONT-SMITH, *supra* note 3, at 324 (explaining that the common law largely excluded members of the general public from enforcing charitable funds). However, some exceptions to the rule of attorney general enforcement have been made under the special interest doctrine. *See infra* Part II.D.1 (discussing the rationale and application of the special interest doctrine).

those charitable beneficiaries who merit standing[57] and to assure consistent application of legal standards to all charities.[58] In addition, private enforcers may not have the personal interest or financial resources to guarantee proper and complete charitable enforcement.[59] Most importantly, attorney general enforcement protects charities from vexatious litigation,[60] thereby fostering more efficient use of charitable funds.[61] Ultimately, without a centralized system of enforcement through the attorney general, charities would devote more of their resources to legal matters and ultimately deplete the amount of money available for charity work in society.[62] Despite these justifications for attorney general enforcement, as the next Section discusses, this enforcement regime is not a perfect system.

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57. Given the large and indefinite nature of the charitable beneficiary class, it is difficult to identify those individuals who have a legally protected interest in the charity. *See* Karst, *supra* note 3, at 436-37 (noting that in a charitable organization there is no beneficiary comparable to a private trust holder or a shareholder in a business corporation). The highly individualized and factual inquiry necessary to determine standing in these cases would require additional judicial line-drawing, could create more confusion and, ultimately, higher operational costs for charities. *Id.*

58. In theory, centralized supervision through the attorney general ensures that enforcement of charitable trusts and nonprofit corporations is systematic and consistent among the different charities within each state.

59. Private enforcement can lead to conflicting legal rules and disparate application of laws and case outcomes, all of which deflect charitable funds away from their intended purposes and negate the social benefit of a functional charity sector. *See* Blasko ET AL., *supra* note 18, at 39 (warning that increased charitable enforcement would lead to a "loss of confidence in private charities' administration, either by individual donors to charitable corporations or by those planning to establish charitable trusts").

60. Vexatious litigation arises in two contexts. First, it occurs when those individuals with an insignificant, outside, or passing interest in a charity are permitted to challenge a charity's action. *Cf. id.* at 82 (explaining that most charitable entities lack a formally recognized membership). Second, vexatious litigation can arise simply where a large number of potential beneficiaries exists. *See* Haskell, *supra* note 6, at 25 (raising concerns about the "prospect of vexatious litigation if standing were to be broadened substantially"). The general public, the charitable beneficiary, is largely undefined and encompasses a countless number of individuals. *See* Katz, *supra* note 24, at 709 (describing charitable beneficiaries as the public and the community "at large"). If each member of the public were a beneficiary with standing to enforce a charity, the amount of potential private litigation would be overwhelming. *See* Blasko ET AL., *supra* note 18, at 39 (discussing the high social costs that an expansion of charitable enforcement would impose, "especially in opening charities to potentially vexatious litigation").

61. Limiting private party enforcement ultimately frees donated funds for use in education, poverty alleviation, healthcare, or some other socially valuable cause. Barring private parties from challenging charitable administration is practical because it saves charities money in the form of litigation costs, potential liability, and reduced operating costs. *See* Karst, *supra* note 3, at 449 ("Members of the public at large cannot sue to enforce the duties of a charitable fiduciary, because if the rule were otherwise 'it would be possible to subject the charity to harassing litigation.'" (quoting 4 SCOTT, TRUSTS § 391 (1956))).

62. *Id.*

### *C. Failures of Attorney General Enforcement and Alternative Enforcement Mechanisms*

#### *1. Attorney General failures*

Although it is difficult to accurately measure the amount of wrongdoing in the nonprofit sector,[63] recurring nonprofit scandals suggest that attorney general enforcement is not effectively addressing the problem.[64] It is widely agreed that state attorneys general have failed to adequately prevent, detect, and prosecute misconduct or fiduciary breaches in the nonprofit setting.[65]

Many factors contribute to the failure of the attorneys general. Primarily, this failure stems from a lack of funding specifically for attorney general charitable enforcement.[66] As a result, attorneys general are understaffed,[67] deficient in time and resources, and ill-equipped to litigate breaches of charitable fiduciary duties.[68] The unavailability of reliable charity financial information[69] and the other responsibilities of the attorney general also limit charitable enforcement.[70] Additionally, the political self-interest of the attorney

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63. *See* Marion R. Fremont-Smith & Andras Kosaras, *Wrongdoing by Officers and Directors of Charities: A Survey of Press Reports 1995-2002*, http://ssrn.com/abstract=451240 (last visited July 18, 2006) (prefacing their study, which compiled and classified news reports of nonprofit scandals, with the caveat that the actual extent of wrongdoing in the nonprofit sector is difficult to estimate).

64. *See supra* notes 7-15 and accompanying text (discussing recent scandals involving questionable compensation and spending by university presidents Benjamin Ladner and Peter Diamondopoulos).

65. *See, e.g.*, Fishman, *supra* note 41, at 268 ("[S]tate attorney general offices have neither the person-power, nor sometimes the will, to monitor nonprofits effectively.").

66. *See, e.g.*, David Villar Patton, *The Queen, the Attorney General, and the Modern Charitable Fiduciary: A Historical Perspective on Charitable Enforcement Reform*, 11 U. FLA. J.L. & PUB. POL'Y 131, 164-65 (2000) ("[C]ritiques can largely be boiled-down to the assertion that . . . [the] state attorney general suffers from a lack of funds. . . .").

67. Understaffing of charitable enforcement divisions prevents the proper and thorough investigation of allegations of wrongdoing, and severely hinders effective prosecution of those legitimate charges that are uncovered. *See* Blasko ET AL., *supra* note 18, at 48 (discussing the epidemic understaffing of charitable enforcement actions in attorney general offices nationwide, and noting that less than one-fifth of the offices assigned full-time attorneys to charitable enforcement cases and slightly more than one-fifth assigned no attorneys at all).

68. *See* Patton, *supra* note 66, at 164-65 (asserting that state attorneys general face extremely heavy caseloads).

69. *See* Karst, *supra* note 3, at 451-55 (discussing the lack of, and need for, detailed financial reporting requirements to improve the effectiveness of charitable enforcement by the attorneys general). Without the statutory power to continually access financial information through a disclosure system, attorneys general are reliant on nonprofit whistleblowers and suspecting citizens for tips on fiduciary breaches. *Id.* at 452-53. Once investigations are actually pursued, the lack of reliable information further delays and limits attorney general effectiveness. *Id.* at 455.

70. *See* Blasko ET AL., *supra* note 18, at 38-39 (commenting that the existence of other attorney general duties contributes to selective prosecution of only the worst

general may influence or impede the oversight of charitable accountability among prominent members of the community.[71]

*2. Enforcement alternatives*

In light of these problems, scholars offer several different reform models to enhance the effectiveness of attorney general enforcement.[72] The first and most basic is a call for increased attorney general funding.[73] Increased funding directly alleviates the obvious problems of lack of time, staff, and investigatory resources.[74] More money leads to more staff and attorneys, better investigation of allegations of charity misdeeds, and more time spent actually litigating legitimate cases. Yet, the realities of politics, history, and funding priorities make this change unlikely or inadequate.[75] Despite

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cases of charitable abuse). Attorneys general are not exclusively committed to charitable enforcement and must prioritize other important duties such as crime prevention. *Id.* The multi-faceted public role of the attorney general lowers the effectiveness of attempted accountability, as it diverts time and resources away from charitable enforcement. *Id.*

71. *See* Evelyn Brody, *Whose Public? Parochialism And Paternalism In State Charity Law Enforcement*, 79 IND. L.J. 937, 947-48 (2004) [hereinafter Brody, *Whose Public?*] (noting also that some charitable enforcement cases may be irresistible to incumbent attorneys general). In most states, where the attorney general is elected, he or she is dependent on campaign contributions and popularity amongst the people. *Id.* at 948 & n.40. Often, charitable directors accused of misconduct are the prominent business professionals or political actors who contribute financially or politically to the reelection of the attorney general. *See id.* at 948 & n.41 (asserting that the pressures on attorneys general are similar to those on any other politician). The attorney general's self-interest in protecting these prominent individuals from public scandal may serve as an important underlying factor in the decision not to prosecute or investigate allegations of wrongdoing. *Id.*

72. *See* FREMONT-SMITH, *supra* note 3, at 336-37 (cataloging the various scholarly calls for enforcement reform in the nonprofit sector).

73. *See* Karst, *supra* note 3, at 451-52. Some commentators also suggest that along with increased funding, states should expand the attorney general's statutory power to gather financial information from charities. *See id.* (suggesting that states follow New Hampshire's lead by implementing mandatory reporting systems); *see also* Reiser, *There Ought to Be a Law*, *supra* note 3, at 611-12 (arguing that recent reforms instituting stricter charitable disclosure will be effective only if attorneys general are simultaneously given more resources to utilize the newly collected data).

74. *See* Karst, *supra* note 3, at 451-53. However, increased funding for attorney general enforcement fails to address the problem of attorney general political self-interest. *See, e.g.*, Brody, *Whose Public?*, *supra* note 71, at 947-48 (noting that most attorneys general are elected officials subject of political pressure). Increased funding does not solve, nor even consider, this essentially human problem of self-interest and favoritism, and therefore cannot be the panacea for current enforcement failures.

75. *See* Brody, *Whose Public?*, *supra* note 71, at 947-48 (discussing the pressures on politically accountable attorneys general). *See* Blasko ET AL., *supra* note 18, at 48 (noting, even after decades of public debate over charitable enforcement, that less than one-fifth of attorney general offices assigned full-time attorneys to charitable enforcement cases and slightly more than one-fifth assigned no attorneys at all).

over fifty years of critical calls for charity reform, legislators continue to prioritize other spending initiatives over charitable enforcement.[76]

Others propose the creation of state charity oversight boards to monitor, investigate, advise, and litigate against charities.[77] These reforms are based on the theory that full disclosure and access to charity financial information will spur greater accountability.[78] However, in this age of deregulation, neither legislators nor the public are likely to embrace new bureaucracies.[79] Creating charity oversight boards requires significant state government restructuring at a substantial public cost, and increases the cost of continual disclosure for charities.[80] These expenses, the public hesitation to increase government regulation, and the historically low priority of funding charitable accountability make this reform doubtful. Increased IRS oversight is another common suggestion.[81] Both the

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76. In the forty years since Karst's publication of *The Efficiency of the Charitable Dollar*, nearly all commentators have suggested the need for additional funding of attorneys general as a necessary component of improved accountability. *See supra* note 3 and accompanying text (discussing various approaches to increase nonprofit accountability). However, despite congressional consideration of the problem on many occasions, as well as nonprofit corporation law reforms, funding for charitable enforcement programs has not changed significantly. *See* Reiser, *There Ought to Be a Law*, *supra* note 3, at 566-68 (classifying legislative action on nonprofit reform as still in the early stages); *see also* Blasko ET AL., *supra* note 18, at 48 (describing the lack of attorney general staffing).

77. *See* Karst, *supra* note 3, at 476-82 (urging the creation of state charity oversight boards); *see also* FREMONT-SMITH, *supra* note 3, at 375 (discussing the general disinterest with which states have viewed scholarly suggestions of charity oversight boards).

78. *See* Reiser, *There Ought to Be a Law*, *supra* note 3, at 562-68 (discussing the recent state and federal legislative focus on disclosure-based reform).

79. *See* FREMONT-SMITH, *supra* note 3, at 375 (considering the inherent difficulties of implementing suggested oversight agency reforms). In light of the current inability to accurately estimate the extent of nonprofit malfeasance and fraud, an expensive system of oversight may be an over-reaction to inflated fears of nonprofit directors' misbehavior. *See* Fremont-Smith & Kosaras, *supra* note 63, at 2 (stating that the irregular policing of nonprofits and the private nature of many settlement agreements inhibits the ability to estimate the scope of nonprofit malfeasance).

80. The additional costs of mandatory financial disclosure, similar to that required of public corporations by the Securities and Exchange Commission, contradict the underlying policy goal of freeing charitable funds for more efficient use in charitable purposes. *See* Karyn R. Vanderwarren, *Financial Accountability In Charitable Organizations: Mandating An Audit Committee Function*, 77 CHI.-KENT L. REV. 963, 964 (2002) ("[P]roposed reforms must address the need for public accountability without interfering with the independence that charities require to carry out their missions.").

81. *See* FREMONT-SMITH, *supra* note 3, at 377-78 (explaining that federal charity oversight has developed primarily through the tax code, not other federal regulatory agencies like the Justice Department, mainly due to "historical accident"). Recently, the U.S. Congress enacted intermediate sanctions that provide the IRS with further tools to monitor charitable activity. *See generally* Cerny & Livingston, *supra* note 3 (outlining in detail the 1998 IRS intermediate sanctions, which impose tax penalties against abuse of charitable funds for personal benefit, and discussing their impact on such college and university financial decisions as presidential compensation).

overlap between tax-exempt[82] and nonprofit organizations and the IRS's extensive knowledge of charities support this alternative.[83] However, IRS oversight is unlikely to fix charitable enforcement problems because matters of tax status and organizational structure are distinct and do not lend themselves to shared enforcement.[84] The IRS may have more access to information, but it has no mechanism or authority to enforce charitable fiduciary responsibilities.[85] In addition, IRS enforcement presents the same problem of resource reallocation as reforms calling for increased funding of state attorneys general.[86]

Increased private enforcement—through derivative suits,[87] realtor actions,[88] and liberalized standing rules—is the most feasible and

82. "Tax-exempt status" refers to exemption from federal income taxes offered to those organizations that qualify under section 501(c) of the Internal Revenue Code. *See also* FREMONT-SMITH, *supra* note 3, at 58 (explaining the tax exemption provisions available under the different subsections of section 501(c) and the types of organizations falling into each category).

83. *See* Cerny & Livingston, *supra* note 3, at 965-67 (examining the IRS' role in oversight of nonprofit corporations and its resulting wealth of information in charities).

84. Tax-exempt status only addresses an organization's relationship with the federal government for tax purposes, whereas state incorporation law governs nonprofit structure and operation. *See* Brody, *Institutional Dissonance*, *supra* note 3, at 435-36 (dispelling the common public "conflation" between nonprofit corporations and tax-exempt organizations, and defending states' independent need to monitor nonprofit organizations despite their tax status). Increased use of the IRS will reach only those charitable organizations that depend on 501(c) exempt status, and will not necessarily be able to police non-exempt charities. *Id.*

85. *See* Hansmann, *supra* note 4, at 602-04 (concluding that the IRS does not have any direct interest in proper nonprofit fiduciary behavior, and therefore, is not the appropriate vehicle for supplemental enforcement). Charitable and nonprofit fiduciary standards exist under state law, not federal tax codes. The IRS has no established mechanism to interpret or enforce fiduciary duties in state courts and also lacks the jurisdiction to promulgate its own corporate fiduciary standards. *Id.* Charitable oversight requires the IRS to act beyond the scope of its mission, and would further complicate the federal tax system. *Id.*; *see also* Karst, *supra* note 3, at 443 (stating that expanded enforcement by the IRS is an indirect, and therefore less efficient, method of increasing charitable fiduciary standards; policing fiduciary breaches is also beyond the scope of the IRS's mission of collecting tax revenue and preventing abuse of charities for personal gain and tax avoidance).

86. Mobilizing the IRS would require the federal government to provide more funding for additional staff, investigatory time, and resources, which is unlikely given the congressional history of de-prioritizing nonprofit accountability issues. *Cf.* Hansmann, *supra* note 4, at 604 (hypothesizing that burdening the IRS with the duty to police transactions for honesty and fair dealing at current funding levels would dilute its mission, which is the collection of government revenue).

87. *E.g.*, REVISED MODEL NONPROFIT CORP. ACT § 6.30 (1987) (establishing the right of members to bring derivative actions).

88. Realtor actions are a blended form of private and attorney general enforcement. Here, private parties are "allowed to proceed in the name of the people or the attorney general," but carry the costs of litigation themselves. Blasko ET AL., *supra* note 18, at 49-50. According to Blasko, realtor actions are an attractive, but ultimately ineffective supplement to attorney general enforcement. *Id.* Although they enhance charity enforcement at no real additional cost to the state,

preferred enforcement alternative for a number of reasons.[89] Primarily, private enforcement increases accountability without substantially or directly raising public costs, since private parties bear the costs of litigating cases.[90] In addition, increased exposure to private litigation promotes accountability as it encourages charity directors to observe their fiduciary obligations more closely to avoid litigation altogether.[91] Private enforcement also solves the political self-interest problem by removing the attorney general from the decision to litigate.[92] Both corporate and trust law recognize the utility of private actions through shareholder derivative suits[93] and the common law doctrine of special interest standing,[94] which are discussed in greater detail in the following Section.

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the fact that the attorney general retains ultimate control over the case and may "withdraw, dismiss, or compromise it at any time" seriously undermines the force of private litigation incentives. *Id.* at 49.

89. *See* Goldschmid, *supra* note 3, at 652-53 (arguing for expanded use of private party enforcement through derivative and realtor actions because private enforcement is the most cost-effective method of increasing charitable accountability); *see also* Patton, *supra* note 66, at 176 ("[R]eform predicated on increased standing is particularly compelling . . . [because it] accomplishes a number of laudable policy goals such as (1) recognizing the reality that other parties, apart from the state attorney general, have a legitimate stake in charities, (2) bolstering overall enforcement, and (3) avoiding the pitfalls of over-regulation, such as vexatious and wasteful litigation.").

90. *See* Blasko ET AL., *supra* note 18, at 53-59 (comparing nonprofit derivative suits to those brought by corporate shareholders). Private enforcement allows individual parties with legally recognized interests in the charity to invest their own time, money, and labor in investigating and litigating charges of maladministration. *Id.* The private enforcement regime capitalizes on the natural, individual self-interest arising in economic agency relationships to monitor fiduciary actions and promote accountability. *Id.* Nonprofit members, donors, consumers, and beneficiaries already have incentives to monitor and prosecute breaches of fiduciary duty. Allowing private enforcement therefore, saves the government from manufacturing this incentive through a state function, which costs the government and the public less. *See* Goldschmid, *supra* note 3, at 652 (suggesting realtor actions to supplement improved governmental enforcement).

91. *See id.* at 652-53 (advocating expanded use of derivative litigation by donors, members, and beneficiaries to make charitable enforcement more effective because "less restrictive standing rules . . . provide significant self-protective incentives for more active nonprofit governance and could create the deterrence necessary to make substantive fiduciary standards effective").

92. In derivative suits and actions under the special interest doctrine, the attorney general's office does not have the same preemptive powers of withdrawal and dismissal that it enjoys in realtor actions. *Cf.* Blasko ET AL., *supra* note 18, at 49-50 (explaining the extensive involvement of the attorney general in any realtor action and discussing why this control severely undercuts quasi-private enforcement alternatives).

93. *See id.* at 53 (explaining that shareholder derivative suits serve as a central mechanism for enforcing fiduciary duties of corporate directors and managers, efficiently ensuring the proper alignment of shareholder and management interests).

94. *See id.* at 49-50, 59-61 (discussing derivative suits in the corporate context and the origins and purposes behind the special interest doctrine in the context of charitable trusts); *see also infra* Part I.D.1 (noting that some courts have extended the

### D. *Mechanisms for Private Charitable Enforcement*

Two forms of private charitable enforcement exist. Under trust law, the special interest doctrine allows individual charitable beneficiaries to enforce charitable duties if they hold an interest in the charity sufficiently distinct from the public interest.[95] Under corporate principles similar to those of the shareholder derivative suit, member derivative suits allow recognized nonprofit members to enforce the fiduciary duties of nonprofit directors.[96]

#### 1. *The special interest doctrine*

The special interest doctrine developed from the common law of trusts to supplement attorney general enforcement through limited private party litigation.[97] Under the doctrine, if charitable beneficiaries can demonstrate a "special" interest in the charity—one that is sufficiently distinct from the public interest—they can proceed with an enforcement action without involving the attorney general.[98] Although based in charitable trust law, courts have also applied the special interest doctrine to cases involving charitable nonprofit corporations.[99] Scholars view the special interest doctrine as a well-reasoned and important component of charity enforcement[100] and urge its expanded use to increase charitable accountability.[101]

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special interest doctrine to allow suits against nonprofit corporations).

95. *See* Blasko ET AL., *supra* note 18, at 59-78 (discussing the special interest doctrine, its component factual considerations, and the application of this doctrine in certain cases); *see also infra* Part I.D.1 (noting that the special interest doctrine developed from the common law of trusts to supplement attorney general enforcement).

96. *See, e.g.*, REVISED MODEL NONPROFIT CORP. ACT § 6.30 (1987) (setting forth parameters for member derivative suits); *see also* FREMONT-SMITH, *supra* note 3, at 334-36 (discussing the statutory provisions enabling member derivative suits under the RMNCA, California Nonprofit Code and New York Nonprofit Corporate Code); *infra* Part I.D.2 (discussing member derivative suits further).

97. *See* Blasko ET AL., *supra* note 18, at 39-40, 54-55 (emphasizing that, while the general public is the primary beneficiary of charity work, certain individuals may have a greater interest in a specific charity than the public, and that the attorney general is, at times incapable, unaware, or uninterested in representing these distinct and legitimate interests).

98. FREMONT-SMITH, *supra* note 3, at 328. (explaining that the special interest doctrine operates as an exception to the general rule of exclusive attorney general standing, and institutes a limited opportunity for private parties to enforce charitable purposes)..

99. *See, e.g.*, Lopez v. Medford Cmty. Ctr., Inc., 424 N.E.2d 229, 233 (Mass. 1981) (granting special interest standing against a charitable corporation). *See generally* Blasko ET AL., *supra* note 18, at 52 ("[T]he 'special interest' doctrine has been used by some courts to expand standing to sue both charitable trusts and [nonprofit] corporations."); RESTATEMENT (SECOND) OF TRUSTS § 391 (1959) (stating that private parties with special interests have standing to enforce a charitable trust).

100. *See* Patton, *supra* note 66, at 170 (characterizing the special interest doctrine as "a sound basis in which to grant standing to legitimately interested beneficiaries

Whether a court grants special interest standing depends on the exclusivity of the attorney general's enforcement power and on the factual circumstances of the individual case.[102] Mary Grace Blasko and her associates have identified five factors that courts use to determine whether a plaintiff holds a sufficiently special interest to qualify for the standing under the doctrine. These factors are:

> (a) the extraordinary nature of the acts complained of and the remedy sought by the plaintiff; (b) the presence of fraud or misconduct on the part of the charity or its directors; (c) the state attorney general's availability or effectiveness; . . . (d) the nature of the benefited class and its relationship to the charity; . . . [and (e) the] subjective and case-specific factual circumstances.[103]

This list is not a defined test, but a compilation of the many facts that courts have explicitly or implicitly considered in their decisions on special interest standing.[104] Courts may use one, all, or a combination of these factors to justify a decision to withhold or allow private parties to proceed with charity enforcement actions.[105]

### *2. The nonprofit member derivative suit*

The second private enforcement mechanism, the nonprofit member derivative suit, arose by analogy to the corporate law.[106] In

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and to deny standing to those who would merely bring nuisance suits against fiduciaries").

101. *See* Goldschmid, *supra* note 3, at 652-53 (claiming that expanded private party enforcement through derivative and realtor actions is the most cost-effective method of increasing charitable accountability). However, a realtor, a private party "allowed to proceed in the name of the people or the attorney general," is an attractive, but somewhat ineffective supplement to attorney general enforcement. Blasko ET AL., *supra* note 18, at 49-50. Although private parties take the lead and carry the costs of prosecuting cases against suspected charity abuses, the attorney general retains ultimate control over the case, so that the inherent problems of political self-interest in attorney general enforcement remain. *Id.*

102. In the majority of states, the attorney general's enforcement power is not exclusive. *See, e.g.*, Holt v. Coll. of Osteopathic Physicians & Surgeons, 394 P.2d 932, 934-35 (Cal. 1964) (noting that the majority position is that persons with special interests may bring enforcement actions); *see also* RESTATEMENT (SECOND) OF TRUSTS § 391 (listing those parties qualified to enforce a charitable trust, including the "Attorney General or other public officer, . . . a co-trustee, or . . . a person who has a special interest in the enforcement of the charitable trust"). However, in some states, state law provides that the attorney general is the sole charitable enforcer. *See, e.g.*, Miller v. Alderhold, 184 S.E.2d 172, 177 (Ga. 1971) (Grice, J., concurring) (denying standing to students on the grounds that the Georgia statute gives the attorney general "sole and exclusive power and duty" to enforce charitable trust administration).

103. Blasko ET AL., *supra* note 18, at 61.

104. *Id.*

105. *Id.*

106. Corporate shareholders have long enjoyed the right to institute derivative suits on behalf of the corporation. *E.g.*, Dodge v. Woolsey, 59 U.S. 331, 335 (1855) (recognizing shareholder derivative rights for the first time in American

most states,[107] which generally follow the approach of California and the RMNCA,[108] nonprofit members have a statutory right to pursue derivative actions on behalf of the corporation.[109] Like shareholders, members may use the derivative action to enforce the legal claims of the nonprofit corporation, including the guarantees of director fiduciary duties.[110]

The derivative action is available as a method of private charitable enforcement only to nonprofit members.[111] Therefore, an appreciation of the flexibility of membership structure offered by the

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jurisprudence). In a derivative action, the shareholder seeks to vindicate rights belonging to the corporation itself, not any direct right belonging to the individual shareholder. *Id.* Therefore, shareholder plaintiffs do not recover individual damages, but return any damages recovered to the corporation. *See generally* Susanna M. Kim, *Conflicting Ideologies of Group Litigation: Who May Challenge Settlements in Class Actions and Derivative Suits?*, 66 TENN. L. REV. 81, 99-106 (1998) (discussing the historical background, development, and purposes of shareholder derivative suits). The closely identical structures of nonprofit and business corporations put nonprofit members and shareholders in similar relationships to their respective corporations. *See* FREMONT-SMITH, *supra* note 3, at 334-35 (explaining how the positions of nonprofit members and shareholders give rise to "the same rights and liabilities"). By analogy therefore, nonprofit members also should enjoy the long-standing right of shareholders to enforce corporate rights through derivative suits. *Id.*

107. Even where state corporation laws do not expressly provide for nonprofit member derivate suits, courts have recognized such derivative rights by analogy to the corporate shareholder context. *E.g.*, Bourne v. Williams, 633 S.W.2d 469, 471-72 (Tenn. Ct. App. 1981) (recognizing common law rights of nonprofit members to bring derivative actions); *see* Boykin, *supra* note 46, at 1007-08 (detailing the judicial creation of member derivative rights in states where nonprofit corporation law was silent on the issue, or spoke only of shareholders' derivative rights).

108. *See* Moody, *supra* note 48, at 266 ("[T]he [RMNCA] adopts the California approach in that it accept[s] the classifications used by California to wit: public benefit, mutual benefit, and religious corporations. It also incorporates much of the regulatory aspects of the California statute with respect to the powers of enforcement entrusted to the Attorney General.").

109. *See* REVISED MODEL NONPROFIT CORP. ACT § 6.30 (1987) (establishing rights to a member derivative suit under the Model Act); N.Y. NOT-FOR-PROFIT CORP. LAW § 623(a) (McKinney 1985) (creating a nonprofit member derivative action designed to mirror the New York business corporation law); CAL. CORP. CODE §§ 5710, 7710 (West 1985) (allowing nonprofit member derivative suits in California for two of the three types of nonprofit organizations in the state); *see also* Boykin, *supra* note 46, at 1005-07 (discussing the development of member derivative suits under these state laws).

110. *See* Boykin, *supra* note 46, at 1004 (describing shareholder derivative suits as a useful method for enforcing officer and director fiduciary duties in the business corporation); *see also* Note, *When Should Courts Allow the Settlement of Duty-of-Loyalty Derivative Suits?*, 109 HARV. L. REV. 1084, 1085 (1996) (noting that derivative suits are necessary in the corporate context because ownership is separated from management). *See generally* Leslie Larkin Cooney, *A Modality for Accountability to Shareholders: The American Way?*, 28 OKLA. CITY U. L. REV. 717, 718-24 (2003) (explaining the procedure, uses, and history of shareholder derivative suits in America).

111. *See, e.g.*, O'Donnell v. Sardegna, 646 A.2d 398, 410 (Md. 1994) (denying derivative claims of health insurance subscribers against a non-stock, nonprofit insurance provider because they did not meet the requirements for technical membership under Maryland corporation law).

RMNCA[112] is pivotal to determining whether member derivative suits are possible.[113] As a result of this freedom, some nonprofit corporations operate completely free from the accountability demands that a membership or shareholder class creates.[114]

The RMNCA sets two requirements for membership, and consequently, derivative litigation rights. Members must enjoy substantial voting rights within the nonprofit and these rights must be expressly granted in the articles of incorporation.[115] More noteworthy is what the RMNCA does *not* require for nonprofit membership—actual ownership.[116] Since valuable consideration is not required for membership status, member derivative rights cannot be explained by any actual proprietary interest or equity ownership of the nonprofit corporation.[117] Thus it appears that the rationale for membership derivative suits is attributable instead to members' control of and commitment to the organization.[118] The RMNCA recognizes that voting rights represent the personal, continuing interest and

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112. *See* REVISED MODEL NONPROFIT CORP. ACT § 6.01(a) (allowing for the possibility of nonprofit corporations with no members at all).

113. *See* Robin Dimieri & Stephen Weiner, *The Public Interest and Governing Boards of Nonprofit Health Care Institutions*, 34 VAND. L. REV. 1029, 1037 (1981) (discussing situations wherein membership is coterminous with the board of directors, which effectively insulates the board from any independent criticism). If a nonprofit corporation incorporates without creating a membership class in its articles of incorporation, it will not generally be subject to enforcement suits by anyone other than the attorney general. *Id.* This flexibility under the RMNCA combined with the ineffective level of attorney general enforcement makes self-governing nonprofit directors, in reality, accountable to no one.

114. *See id.* (noting that insufficiently monitored nonprofit boards create a danger that the board will be captured by management); Dana Brakman Reiser, *Dismembering Civil Society: The Social Cost Of Internally Undemocratic Nonprofits*, 82 OR. L. REV. 829, 830 (2003) [hereinafter Reiser, *Dismembering Civil Society*] (discussing the incentives for nonprofits to choose the non-membership form available under the RMNCA membership governance structure).

115. *See* REVISED MODEL NONPROFIT CORP. ACT § 1.40(21) (defining a member, without regard to what a person is called in the articles of incorporation, on the basis of the right to vote for the election of a director); *see also* Moody, *supra* note 48, at 270-71 (discussing the changed definition of member under the RMNCA, which incorporated a voting requirement).

116. *See* REVISED MODEL NONPROFIT CORP. ACT § 6.02 (allowing members to be admitted for no consideration whatsoever); *see also* Moody, *supra* note 48, at 271 (associating membership rights with participation, not equity or financial ownership).

117. *See* Rob Atkinson, *Unsettled Standing: Who (Else) Should Enforce the Duties of Charitable Fiduciaries?*, 23 J. CORP. L. 655, 671 (1998) (distinguishing shareholders' actual proprietary basis for derivative suits from that of members' derivative rights); Moody, *supra* note 48, at 270-71 (characterizing members' relationship to the nonprofit as one primarily of "participation rather than . . . financial interest generated by an investment").

118. *See* Moody, *supra* note 48, at 271 (correlating membership more closely to an individual's function within the organization). *Cf.* REVISED MODEL NONPROFIT CORP. ACT § 1.40 (listing control through voting as the defining characteristic of nonprofit membership).

commitment that members have to the goals, operation, and mission of the nonprofit.[119] The member derivative suit therefore implicitly acknowledges that individuals who seek some control of the organization hold an interest in charitable enforcement that is distinct from the public interest and is privately enforceable.

## II. CHARITABLE FORM AND ENFORCEMENT IN THE PRIVATE UNIVERSITY CONTEXT

### A. Private Universities As Nonmember Nonprofit Corporations

Private universities serve the charitable purpose of education[120] and may organize either as charitable trusts or nonprofit corporations.[121] Due to their size and complexity,[122] the flexibility of the corporate form,[123] and the overall trend in the nonprofit sector to "go corporate,"[124] nearly all private colleges today operate as nonprofit corporations.[125]

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119. *See* Moody, *supra* note 48, at 273 (noting that the member-nonprofit relationship is more personal in nature when compared to the purely profit-driven shareholder-corporation relationship).

120. *See* Trustees of Dartmouth Coll. v. Woodward, 17 U.S. (4 Wheat.) 518, 562-63 (1819) (describing private universities as eleemosynary institutions which serve the long-recognized charitable purpose of education). Societies throughout time have recognized education as one of the original charitable purposes. *See* FREMONT-SMITH, *supra* note 3, at 3 (listing educational associations as charities in times as early as Ptolemy, Plato, and ancient Rome). The recognition of education as a charitable purpose continues today in America. *See* I.R.C. § 501(c)(3) (recognizing education as an approved federal tax-exempt charitable purpose).

121. *See supra* notes 28-32, 35 and accompanying text (defining both forms as serving a charitable purpose).

122. *See* Robert E. McCormick & Roger E. Meiners, *University Governance: A Property Rights Perspective*, 31 J.L. & ECON. 423, 424 (1988) (summarizing the development of the complex, multi-tiered administrative structure of modern colleges, including faculty members, departments, deans, presidents, and boards of trustees).

123. *See* Algo D. Henderson, *Control in Higher Education: Trends and Issues*, 40 J. HIGHER ED. 1, 3 (1969) (noting the many advantages of the corporate form for universities). The corporate form offers more flexibility for universities in organizational structure and applicable legal standards. *Id.* Nonprofit university incorporators have the option to include members in their organizational structure, establish those members' rights and privileges, and determine the number and roles of directors or trustees. REVISED MODEL NONPROFIT CORP. ACT §§ 6.03, 6.10, 8.03. Greater corporate flexibility also exists in the lower corporate fiduciary standards of care and loyalty that govern the behavior of nonprofit directors and executives. *See* Stern v. Lucy Webb Hayes Nat'l Training Sch. for Deaconesses & Missionaries, 381 F. Supp. 1003, 1014-15 (D.D.C. 1974) (applying corporate, not trust fiduciary standards, to the actions of nonprofit hospital directors and administrators); FREMONT-SMITH, *supra* note 3, at 52-53 (explaining the more lenient application of corporate fiduciary standards that apply to charitable directors).

124. *See* FREMONT-SMITH, *supra* note 3, at 49-50 (detailing the popularity of the corporate charitable form in America).

125. *See* John A. Beach, *The Management And Governance Of Academic Institutions*, 12

The governance structure of a private university mirrors that of a business corporation. Boards of trustees, like corporate boards of directors, broadly govern the university's mission and oversee the performance of university administrators and faculty.[126] University presidents, like executive officers, manage the ongoing operations of the school, implement the goals and policies set by trustees,[127] and answer ultimately to them.[128] Since private universities generally do not recognize members in their corporate charters, "shareholders" do not exist in the university setting and therefore university boards of trustees are typically self-perpetuating.[129] However, where the selection of new trustees or presidents includes alumni or faculty approval, the university begins to resemble a mutual or member-governed nonprofit corporation.[130]

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J. COLL. & UNIV. L. 301, 309 (1985) (highlighting the long tradition of colleges and universities organizing as corporations).

126. *See* Emil A. Ricci, *College And University Governance In The United States: An Historical Survey* (1999) (unpublished paper), http://home.comcast.net/~erozycki/HEGovernance.html (last visited July 27, 2006) (asserting that trustees are ultimately responsible for university governance). *See generally* John E. Corbally, Jr., *Boards of Trustees in the Governance of Higher Education*, 9 THEORY INTO PRACTICE 239 (1970) (summarizing critically the role, responsibilities, and actual practices of university boards of trustees).

127. *See* John J. Corson, *The Modernization of the University: The Impact of Function on Governance*, 42 J. HIGHER ED. 430, 436 (1971) (describing the changing role of university presidents away from academic leader and toward administrative and financial director).

128. *See id.* (asserting that many trustees have abdicated their traditional responsibilities to governing officials such as presidents and deans).

129. *See* LOMBARDI ET AL., THE LOMBARDI PROGRAM ON MEASURING UNIVERSITY PERFORMANCE, UNIVERSITY ORGANIZATION, GOVERNANCE, AND COMPETITIVENESS 6 (2002), *available at* http://thecenter.ufl.edu/UniversityOrganization.pdf (explaining that in the typical self-perpetuating board, the university president and current trustees nominate, select, and approve new trustees; students, alumni, and faculty have little or no formal power in selecting members of the governing board).

130. According to Hansmann, the nature of the services that colleges provide and their complicated governance characteristics defy, or at least complicate, the classification of universities under his model. Hansmann, *supra* note 4, at 503-04. He comments,

> [u]niversities, for example, often combine elements of all four types [of nonprofit organizations under this model]: . . . they typically have both donative and commercial aspects; moreover, their boards of trustees are often elected in part by the alumni (who comprise the bulk of the former customers and current donors), and in part are self-perpetuating, so that *they are neither clearly mutual nor clearly entrepreneurial.*

*Id.* (emphasis added).

### *B. Enforcement of University Administrator Fiduciary Duties and University Mission*

As a nonmember nonprofit corporation,[131] enforcement of a school's charitable mission and trustee and administrator fiduciary duties[132] lies primarily with state attorneys general.[133] Regulation of fiduciary duties in the university setting "do[es] not present unique problems,"[134] and so the enforcement failures and alternatives discussed above apply equally in the university context.[135] Given the cost of private university tuition[136] and the importance of college education, this ineffective enforcement of university management and administrator fiduciary duties does not inspire student confidence in private education. This begs the question: what alternatives *are* available for students to protect their educational investment?

### *C. Private Enforcement of University Fiduciary Duties*

In theory, university students may gain standing to challenge university administrative action under one or both of the private enforcement alternatives discussed above.[137] Students can either establish a distinct interest in the university under the special interest doctrine or qualify for nonprofit member derivative rights under state nonprofit law.[138] For a majority of charitable beneficiaries, these two private enforcement vehicles work well to protect their charitable interests, striking the right balance between preventing frivolous litigation and supplementing charitable enforcement.[139] Students, however, have not shared in the same success.

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131. *See supra* Part II.A (explaining the university's status as a nonprofit corporation without members).

132. University administrators owe the classic corporate fiduciary duties of care and loyalty to the university itself. *See* REVISED MODEL NONPROFIT CORP. ACT § 8.30(a) (1987) (establishing the nonprofit director's duty to carry out all activities in good faith, with "ordinarily prudent" care, and in the best interests of the corporation).

133. *See, e.g.*, Miller v. Alderhold, 184 S.E.2d 172, 177 (Ga. 1971) (Grice, J., concurring) (denying university students standing to challenge financial decisions of college trustees, stating that the attorney general has the exclusive power to enforce the charitable purposes and proper administration of charities under Georgia law); *see also supra* Part I.B (discussing the rationale for exclusive or primary attorney general enforcement in the charitable sector).

134. FREMONT-SMITH, *supra* note 3, at 10.

135. *See supra* Part I.C (discussing the enforcement failures of the attorney general and supplemental enforcement options).

136. The average cost of private college tuition is approximately $18,000 per year. *The Skyrocketing Cost of Higher Education, supra* note 20, at 2.

137. *See supra* Part I.D (outlining the two primary private charitable enforcement doctrines: the special interest doctrine and the nonprofit member derivative suit).

138. *Id.*

139. In the prototypical charitable trust, the special interest doctrine allows

*1. Students do not qualify for private party standing under the special interest doctrine*

It is extremely rare that courts will find an adequate basis for university student standing under the special interest doctrine.[140] In approximately 180 years, students have successfully gained standing in only one case,[141] and courts do not appear to be retreating from this stance.

The denial of student special interest standing originates from the 1819 United States Supreme Court opinion in *Trustees of Dartmouth College v. Woodward*.[142] There, trustees of Dartmouth College challenged a state-mandated change to their corporate structure and the conversion of the college into a university.[143] While recognizing the important aggregate interests of the Dartmouth students,[144] Chief Justice Marshall declared that "[t]he students are fluctuating, and no individual among our youth has a vested interest in the institution, which can be asserted in a court of justice."[145] Instead, the Court left representation and protection of the students' interests with the

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beneficiaries whose interest is distinct from and more direct than the general public interest to enforce the charitable purpose or act. *See, e.g.*, Hooker v. Edes Home, 579 A.2d 608 (D.C. 1990) (allowing widows to enforce a charitable trust originally dedicated to establishing a home for elderly widows). Likewise, in a membership nonprofit corporation, the statutory and common law member derivative suit has recognized the nature of members' rights in the nonprofit corporation and allowed the appropriate level of legal relief. *See* REVISED MODEL NONPROFIT CORP. ACT § 6.30 (1987) (recognizing a member derivative suit).

140. *See, e.g.*, Miller v. Alderhold, 184 S.E.2d 172, 175 (Ga. 1971) (denying students standing because they held no vested interest in the university); Assoc. Students of Univ. of Or. v. Or. Inv. Council, 728 P.2d 30, 31-33 (Ct. App. Or. 1986) (denying standing to students challenging university investment decisions because they were a fluctuating class which could identify no interest distinct from the interest of the general population); Blasko ET AL., *supra* note 18, at 64 ("[In most cases courts deny standing to university students primarily because of the amorphous and fluctuating nature of the class of students.").

141. In *Jones v. Grant*, the Alabama Supreme Court found that "the interest of the students . . . as beneficiaries in the financing of the educational institution with which they are associated is a sufficient special interest to entitle them to bring suit." 344 So.2d 1210, 1212 (Ala. 1977). In this case, students, faculty, and alumni of Daniel Payne College brought an action against university trustees and administrators for alleged self-dealing, embezzlement, and misuse of university funds. *Id.* at 1210. This case has been distinguished from the long line of contrary university student cases by the extraordinarily egregious and bad-faith nature of the complained-of acts and the noticeable lack of enforcement or oversight by the attorney general. *See* Blasko ET AL., *supra* note 18, at 64-65 (stating that allegations of fraud strengthened the case for a grant of standing); *Jones*, 344 So.2d at 1212 (pointing to the patent diversion of funds in granting special interest standing).

142. 17 U.S. (4 Wheat.) 518 (1819).

143. *Id.* at 552-53.

144. *See id.* at 642-43 ("[The students'] potential rights . . . amount collectively to a most important interest.").

145. *Id.* at 641.

college's trustees.[146] Thus began the 180-year trend of denying university students standing in charitable enforcement cases.

In interpreting this sentence from *Dartmouth College*, courts have identified two obstacles to university student standing under the special interest doctrine.[147] First is the large, fluctuating, and amorphous nature of the class of university students.[148] Second is the lack of any direct, measurable student injury resulting from the alleged university administrator misdeeds.[149] Courts cite these two barriers to special interest standing so consistently that the denial of standing for the class of university students is nearly "categorical."[150]

*a. The nature of the student class*

The denial of student standing based on the nature of the class as large, fluctuating, and amorphous is fueled in part by practical necessity. University students number into the millions,[151] and at any one time, a large percentage are graduating or matriculating in and out of the student population.[152] Most courts fear that expanded special interest standing will bring increased vexatious litigation against the university by allowing any tuition-paying, enrolled student with no campus experience and little financial investment to challenge university action.[153]

The case of *Miller v. Alderhold* typifies the judicial attitude toward the nature of the student class.[154] There, Atlanta Baptist University students alleged that the university trustees had breached their fiduciary duties by selling school lands and continuing to employ a president who "destroyed the academic integrity of the [c]ollege."[155]

146. *Id.* at 642-43.
147. Blasko ET AL., *supra* note 18, at 72.
148. *Id.*
149. *Id.*
150. *Id.*
151. *See* FREMONT-SMITH, *supra* note 3, at 10 (estimating that twenty percent of all college students nationwide attend private school).
152. Students are a fluctuating class because at any one time, a large section of the student population is new to the school or preparing to leave it. Entering students are unacquainted with university policies and administration, making them less informed, less qualified, and less likely to bring action against the school. Graduating students, who are better-acquainted with administrative operations, soon will lose the legal rights of current students.
153. Blasko ET AL., *supra* note 18, at 41-42; *see, e.g.*, Miller v. Alderhold, 184 S.E.2d 172, 175 (Ga. 1971); Coffee v. William Marsh Rice Univ., 403 S.W.2d 340, 343 (Tex. 1966) (noting that allowing litigation by private litigants who lack enough special interest in the university would subject charities and their trustees to "undue harassment").
154. *Miller*, 184 S.E.2d at 175.
155. *Id.* at 173.

Citing *Dartmouth College*, the Georgia Supreme Court found that the students had no vested interest in the school.[156] The court opined,

> It is inconceivable that one 18-year-old boy or girl the day after his or her admission to a private college could go into court or through the State's Attorneys, and seek to enjoin the trustees in the management and operation of the college . . . solely because he or she was a student.[157]

*b. Students' lack of injury*

Assuming a breach of fiduciary duty has occurred, the student must still establish an actual injury resulting from this breach to gain special interest standing.[158] Courts often deny standing to students because they are unable to demonstrate a direct injury arising from administrator malfeasance.[159] Students face several problems in defining a direct injury from university administrative action. The individual financial loss resulting from the fiduciary breach is difficult to identify because it is derivative in nature[160] and negligible in amount.[161] Also, any identified loss is inextricably tied to other university administrative choices and funds, making the specific cause of that injury difficult to determine.[162] Most courts have also rejected student injuries arising from the lost "reputation value" of their degrees or association with the university.[163] Courts view reputation

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156. *Id.* at 174-75.
157. *Id.* at 175.
158. *Cf. In re* Barnes Found., 684 A.2d 123, 129-30 (Pa. Super. Ct. 1996) (denying standing to art students who challenged the application of art museum trust funds to new purposes because students failed to show they would actually suffer any harm from the new undertaking).
159. Blasko ET AL., *supra* note 18, at 72.
160. The university itself bears the initial financial loss arising from the mismanagement of university assets. Therefore, the school itself holds a legal claim for recovery of those losses. Any injury that students claim as a result of the loss in school reputation is derivative, secondary, and speculative. *Cf.* Trustees of Dartmouth Coll. v. Woodward, 17 U.S. (4 Wheat.) 518, 641 (1819) (stating that students had no direct vested interest in the school).
161. One student's pro rata financial loss is theoretically equal to the percentage of university income that his or her tuition and fees represent. This amount is very small, and in most cases, is not worth the cost of litigating the matter.
162. Tuition payments and unrestricted charitable donations are used similarly by universities and other nonprofit corporations to finance general operations. Tuition funds are combined with other unrestricted donations and used in whatever way administrators deem most appropriate. Therefore, definitively tracing specific expenditures back to their origin as tuition is difficult. *See* Goodwin, *supra* note 6, at 1106 ("[G]ifts to charity are not restricted. . . . These gifts—with no conditions attached—go toward the general operating expenses of the charity to be used as those in charge see fit . . . ."); RESTATEMENT (THIRD) OF TRUSTS § 28, cmt. a (2003) (noting that general charitable donations may be used to fund the charity's general operations).
163. *See, e.g.*, Steeneck v. Univ. of Bridgeport, No. 93-0133773, 1994 WL 463629, at

loss as an indirect and attenuated consequence of alleged misconduct, and its effect is uncertain and difficult to measure.[164] Despite the very real effect that a university's loss of reputation has on students, courts have not signaled any intent to begin recognizing and remedying these damages.[165] Moreover, even if students can show an identifiable and measurable injury, courts find that the student interest in enforcing charitable fiduciary duties is not sufficiently distinct from the public interest to merit special interest standing.[166]

2. *Students do not qualify for private party enforcement through the member derivative suit*

Under the majority view, students are most likely unqualified to institute member derivative suits because they are not legally recognized members under state incorporation laws.[167] Membership is not required of nonprofit corporations under the RMNCA.[168] Therefore, even though member derivative suits exist at law in most states, they are not presently available as enforcement mechanisms of

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*9 (Conn. Super. Ct. Aug. 18, 1994) (denying student standing to challenge the merger of two private educational institutions despite claims that students would suffer loss of academic reputation). *But cf.* Jones v. Grant, 344 So.2d 1210, 1211 (Ala. 1977) (allowing students to proceed with litigation, implicitly recognizing the "reputation interest" of students and faculty without much discussion).

164. In order to recognize a reputation injury, courts must engage in speculative, inconclusive, and overly complicated analysis. *Cf. In re* Barnes Foundation, 684 A.2d 123, 129 (Pa. Super. Ct. 1996) (denying standing of art students who used museum facilities funded by a charitable trust to challenge a financial settlement agreement between the trust and one of its donors because students failed to show any actual harm from the settlement terms, and finding that students actually would benefit in multiple ways).

165. Since *Jones*, no court has recognized student standing to challenge university administrative decisions. Blasko ET AL., *supra* note 18, at 72-73.

166. *See, e.g.*, Assoc. Students of Univ. of Or. v. Or. Inv. Council, 728 P.2d 30, 31-33 (Or. Ct. App. 1986) (denying standing to students challenging the investment of higher education funds in South African apartheid corporations as students' political opposition to apartheid was not sufficiently distinct from the interests of other Oregon residents).

167. *Cf.* O'Donnell v. Sardegna, 646 A.2d 398, 410 (Md. 1994) (denying health insurance plan subscribers standing to bring a member derivative claim against a nonprofit insurance company because they were not members as required under Maryland corporation law); Chambrella v. Rutledge, 740 P.2d 1008, 1016-17 (Haw. 1987) (denying standing to individuals who contributed to a nonprofit project because they were not formal members); Basich v. Bd. of Pensions of the Evangelical Lutheran Church in Am., 493 N.W.2d 293, 296 (Minn. Ct. App. 1992) (holding that plaintiffs could not be considered "members" of the pension board because that nonprofit entity had not recognized members in its articles of incorporation).

168. *See* REVISED MODEL NONPROFIT CORP. ACT § 2.02(a)(5) (1987) (providing that incorporators under the act may choose "whether or not the corporation will have members").

nonprofits that lack a designated member class, such as private universities.[169]

## III. RECOGNIZING UNIVERSITY STUDENT DERIVATIVE RIGHTS

The RMNCA and other state nonprofit reforms make clear that expanded private party action is the preferred supplement to attorney general charitable enforcement.[170] Yet, despite codification of the member derivative suit, the structural flexibility allowed under the RMNCA limits the utility of this supplemental enforcement.[171] In particular, the RMNCA member derivate provisions have failed to supplement enforcement where organizations function as member nonprofits, but do not recognize individual members.[172] Private universities are good examples of these member-focused nonprofits organized technically as nonmember organizations.[173] Universities are primarily committed to educating tuition-paying, enrolled students, but are controlled by self-perpetuating boards of trustees[174] and do not offer students voting membership.[175] This nonmember

169. *See* Moody, *supra* note 48, at 270, n.106 ("If a person . . . does not have the right to vote for directors, that person is not a member [under the RMNCA]."); *see also* Dimieri & Weiner, *supra* note 113, at 1037 (characterizing the lack of an effective member-shareholder body as an "unfortunate situation" that commonly occurs in nonprofit corporations, and that leads to lax accountability standards for nonprofit directors).

170. Blasko ET AL., *supra* note 18, at 39-40 (explaining the need for private party actions despite the resulting inconsistency of enforcement outcomes). The trend toward explicit recognition of member derivative suits under state nonprofit corporation laws also infers the modern preference for private party supplemental charitable enforcement. *See* REVISED MODEL NONPROFIT CORP. ACT § 6.30 (codifying members' rights to bring derivative suits against the nonprofit corporation).

171. *See* Dimieri & Weiner, *supra* note 113, at 1037 (explaining the reduced accountability that results from the common situation where nonprofit corporations have no effective member-shareholder body); *O'Donnell*, 646 A.2d at 405 (strictly construing the definition of nonprofit "member" under the Maryland nonprofit corporation provisions, and disallowing a derivative suit by subscribers to health insurance plans).

172. *See, e.g.*, *O'Donnell*, 646 A.2d at 405 (strictly construing the definition of nonprofit "member" under the Maryland nonprofit corporation provisions, and denying standing to nonprofit health insurance plan subscribers because they were not technically members).

173. *See supra* Part II.A (discussing the structure, purposes, and legal charitable form of private universities as nonprofit corporations, but detailing the member-oriented educational service that they provide).

174. *See* Hansmann, *supra* note 4, at 503-04 (admitting that universities generally have self-perpetuating boards, but nevertheless are difficult to classify as nonmember nonprofits).

175. Students may receive rights to vote in student government elections, but they do not meet the requirements of the voting member under the RMNCA because they normally do not control the selection of university trustees. *See* Morton A. Rauh, *The College Trustee-Past, Present, and Future*, 40 J. HIGHER ED. 430, 440-41 (1969) (noting that students are not typically involved in university trustee selection in any way); REVISED MODEL NONPROFIT CORP. ACT § 1.40(21) (defining "member" for

structure bars students from bringing derivative actions under the RMNCA and other state nonprofit corporation laws and limits the opportunities for private party enforcement in the private university setting.[176]

Despite this lack of membership derivative rights and the longstanding denial of student special interest standing,[177] students may not be completely out of options for enforcing university trustee and administrator fiduciary duties. Based on their similarities to nonprofit members,[178] the need for further enforcement in the university setting,[179] and the modern trend embracing member derivative suits,[180] students may be able to articulate a specific exception for asserting their derivative rights in the university. Under the reasoning of *Stern v. Lucy Webb Hayes National Training School*,[181] which impliedly establishes precedent for recognizing nonprofit derivative actions by nonmembers,[182] courts can examine the

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purposes of the Act as those persons entitled to vote for the election of directors of the corporation).

176. *Cf. O'Donnell*, 646 A.2d at 410 ("We are not persuaded that standing to sue derivatively officers and directors of a nonprofit corporation should be extended to nonmembers, based on their status as contributors to the corporation or as users or buyers of its goods or services."); *see also infra* Part II.C.2 (explaining that students are barred from bringing member derivative suits under the RMNCA due to their lack of technical nonprofit membership status).

177. *See, e.g.*, Miller v. Alderhold, 184 S.E.2d 172, 175 (Ga. 1971) (denying college students standing and finding "inconceivable" a holding granting student special interest standing); *see also* Blasko ET AL., *supra* note 18, at 72-73 (describing how student special interest standing has been broadly denied by courts, particularly in university cases).

178. *See infra* Part III.C.2 (outlining the similarities between private university students and nonprofit members).

179. *See supra* Part II.C (describing the general opinion of attorney general nonprofit and charitable enforcement as ineffective). This ineffectiveness applies equally in the university setting and is well demonstrated in the recurring scandals involving university presidents and trustees. *See infra* Introduction & notes 7-15 (detailing allegations of abuse by former university presidents Ladner, Diamondopoulos, and others).

180. The RMNCA, published in 1987, explicitly codified members' rights to pursue derivative suits into a nonprofit corporation code. *See* REVISED MODEL NONPROFIT CORP. ACT § 6.30 (creating a right of derivative action by members of a corporation under certain circumstances). This inclusion was a direct acknowledgment of the need for supplemental private nonprofit enforcement and recognition of the development of the common law in several states, which had already judicially recognized the rights of members to institute derivative actions. *See* Moody, *supra* note 48, at 254-55, 274 (discussing the evolution of the RMNCA and the intended supervisory effect of member derivative actions on corporate management).

181. Stern v. Lucy Webb Hayes Nat'l Training Sch. for Deaconesses & Missionaries (*Stern I*), 367 F. Supp. 536 (D.D.C. 1973); Stern v. Lucy Webb Hayes Nat'l Training Sch. for Deaconesses & Missionaries (*Stern II*), 381 F. Supp. 1003 (D.C. Cir. 1974). For purposes of this Article, the term "*Stern*" refers to the *Stern I* and *Stern II* cases collectively.

182. *Stern* did not specifically or directly answer whether nonmembers of the

functional reality of the private university and allow students to bring derivative actions against university administrators.[183] *Stern* allows courts to look beyond technical nonprofit membership as a prerequisite to derivative standing[184] and permit interested nonmembers to bring derivative actions against nonprofit corporations in order to fill gaps in charitable enforcement.[185]

### *A.* Stern *Recognizes Nonmember Standing To Bring Derivative Suits Against Nonprofit Corporations*

In *Stern*, the U.S. District Court for the District of Columbia certified a class of former patients to sue the directors of Sibley Hospital, a nonprofit corporation, for breach of their fiduciary duties in allegedly mismanaging hospital funds.[186] These patients were neither recognized members nor donors of the hospital; they were merely former consumers of the hospital's services.[187] In the first of two decisions (*Stern I)*, the district court granted standing to the patients based on their special interest in the hospital, but limited the available relief to the hospital only.[188] In *Stern II*, the same court imposed fiduciary liability on the nonprofit hospital directors under corporate—not trust—standards, but did not revisit the issue of standing under corporate principles.[189]

Although the *Stern* court did not explicitly hold that nonmembers were entitled to bring a derivative suit on behalf of a nonprofit corporation,[190] this was the exact effect of the court's ruling.[191] Other

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nonprofit hospital had standing to bring a derivative action against the hospital. Instead, the district court decided issues of standing on charitable trust enforcement principles and did not find it necessary to revisit its holding on standing when corporate principles were later applied in the case. *See Stern I*, 367 F. Supp. at 540 (concluding without explanation that former patients held a sufficient interest in the enforcement of the hospital's charitable mission to merit special interest standing under trust principles); *see also* O'Donnell v. Sardegna, 646 A.2d 398, 408 (Md. 1994) (noting *Stern*'s use of trust principles to decide whether patients had standing).

183. *See Stern I*, 367 F. Supp. at 540 (enabling interested nonmembers to bring derivative suits against a charitable organization).

184. *See id.* (determining that former hospital patients had standing to enforce the fiduciary duties of hospital directors).

185. *See O'Donnell*, 646 A.2d at 407 (citing *Stern* as the sole precedent supporting nonmembers' standing to enforce the fiduciary duties of nonprofit directors).

186. *Stern I*, 367 F. Supp. at 540; *see also Stern II*, 381 F. Supp. at 1007 (identifying the contentions of former patients who questioned the financial management of the nonprofit hospital and alleged that hospital directors had engaged in self-dealing transactions resulting in the hospital's lost income).

187. *See O'Donnell*, 646 A.2d at 410 (referring to the *Stern* patients as "users or buyers of [the hospital's] goods or services").

188. *Stern I*, 367 F. Supp. at 540; *see O'Donnell*, 646 A.2d at 407-08 (confirming the derivative remedy allowed in *Stern*).

189. *Stern II*, 381 F. Supp. at 1013.

190. *See Stern I*, 367 F. Supp. at 540 (allowing nonmember patients to proceed with

courts have noted that *Stern's* significance for analyzing nonmember standing in nonprofit derivative actions is that "*after the court shifted its duty analysis from the trust model to the corporation model, it never reconsidered whether the patients had standing to sue.*"[192] By refusing to reconsider the issue of standing in the case, *Stern* allowed nonmembers to pursue a derivative cause of action[193] against the nonprofit hospital despite their lack of official or technical membership in the organization.[194]

The *Stern* court considered four factors in allowing nonmember plaintiffs to proceed with a derivative suit against the nonprofit hospital.[195] These four factors are: (1) the presence of a self-perpetuating board;[196] (2) an absence of public regulation of the nonprofit organization;[197] (3) a lack of obligation to disclose the

derivative-type claims against nonprofit directors).

191. *See O'Donnell*, 646 A.2d at 408 (admitting that the effect of *Stern* was to allow nonmember standing in a nonprofit derivative suit, but questioning the applicability of that holding to the case before the court); Newman v. Forward Lands, Inc., 420 F. Supp. 1320, 1322 (E.D. Pa. 1977) (noting that *Stern*'s effect was to allow patients to bring an action very similar to a shareholder derivative suit).

192. *O'Donnell*, 646 A.2d at 408 (emphasis added).

193. The former patients' claims against the hospital in *Stern* were derivative for two reasons. First, the patients were enforcing duties of the hospital directors that ran to the corporation, not the patients themselves. Christiansen v. Nat'l Sav. & Trust Co., 683 F.2d 520, 528 (D.C. Cir. 1982). Second, the court allowed relief for the hospital only—not the patient-plaintiffs—which mirrors the relief available in a corporate derivative suit. *Id.* *See generally* FREMONT-SMITH, *supra* note 3, at 329 (discussing the process of certification of the *Stern* patient class to bring the hospital's claims of fiduciary breaches).

194. In the end, former patients were allowed to litigate alleged breaches of fiduciary duties owed to the hospital and permitted to gain injunctive relief for the nonprofit corporation, not the individual litigants. *See Christiansen*, 683 F.2d at 528; *see also* FREMONT-SMITH, *supra* note 3, at 329 (commenting that the court in *Stern* allowed the plaintiffs to bring the action, but barred them from any personal recovery of damages).

195. In its decisions, the *Stern* court did not explain its reasoning in detail, nor clearly list these four factors. *See Stern I*, 367 F. Supp. at 540-41 (granting standing to plaintiff patients to prevent injury to the hospital without elaboration or in-depth explanation). However, later cases interpreting *Stern* have clarified the factors relevant to the court's logic. *See Christiansen*, 683 F.2d at 527-28 (reflecting on the rationale of the *Stern* court and identifying the factors contributing to standing in *Stern*); *O'Donnell*, 646 A.2d at 408 (examining the meaning of *Stern* when applying its factors to the facts).

196. *Stern II*, 381 F. Supp. 1003, 1019 (D.C. Cir. 1974); *see also Christiansen*, 683 F.2d at 528-29 ("[*Stern*] points out that the hospital is not closely regulated by any public authority, it has no responsibility to file financial reports, and its Board is self-perpetuating.") (internal quotations omitted); *O'Donnell*, 646 A.2d at 410 ("In addition to a self-perpetuating board, the court in *Stern II* considered relevant that the hospital was not closely regulated by any public authority and it had no responsibility to file financial reports.") (internal quotations and alterations omitted).

197. *Stern II*, 381 F. Supp. at 1019; *Christiansen*, 683 F.2d at 529; *O'Donnell*, 646 A.2d at 410.

nonprofit's financial information;[198] and (4) the presence of a private party with a sufficient special interest in the nonprofit corporation.[199]

Other courts interpreting and explaining *Stern* have noted that the most important of these factors is the effective lack of public regulation;[200] *someone* needs to monitor the charity's function, and where state regulatory functions are lacking or nonexistent, private parties have a better claim to standing in enforcement actions.[201] *Stern* also makes clear that nonmember standing will not be granted in the absence of a private plaintiff who is sufficiently interested in the nonprofit.[202] *Stern* did not explicitly discuss the nature of that special interest, nor spell out what type of interest would be sufficient for standing purposes.[203] However, *Stern*'s outcome suggests that the "sufficient special interest" prong is satisfied where nonmembers are merely consumers of the nonprofit's services.[204]

Admittedly, *Stern* is an outlying and somewhat rare case. Thus, its reasoning should be carefully considered before courts fully embrace it as precedent for allowing private party enforcement in the charitable sector.[205] Both the D.C. Circuit Court of Appeals and the Court of Appeals of Maryland have questioned *Stern*'s rationale and

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198. *Stern II*, 381 F. Supp. at 1019; *Christiansen*, 683 F.2d at 529; *O'Donnell*, 646 A.2d at 410.

199. *Stern I*, 367 F. Supp. at 540 (finding that, because the plaintiffs had "a sufficient special interest to challenge the conduct of the trustees operating th[e] charitable institution on a theory of breach of trust," they could "unquestionably" proceed with their claims); *see Christiansen*, 683 F.2d at 528-29 (clarifying that "the *Stern* court allowed the patients to maintain their action . . . because if they could not challenge the directors' breaches of their duties, no one could"); *cf. O'Donnell*, 646 A.2d at 410 (finding an insufficient special interest to grant standing to nonmembers).

200. *See Christiansen*, 683 F.2d at 527-28 (emphasizing that the patients were the only ones in position to challenge the directors' breach of fiduciary duty); *O'Donnell*, 646 A.2d at 409 (explaining that, in the corporate context, private party derivative standing is a necessary constraint on the actions of officers and directors).

201. *See O'Donnell*, 646 A.2d at 410-11 (denying private party standing because the available public regulation of the health insurance provider included the insurance commissioner, tax assessors, and the attorney general, who were armed with recent enactments of stricter regulatory laws regarding the health insurance industry).

202. *See Stern I*, 367 F. Supp. at 540 (finding that former patients of Sibley Hospital did have a sufficiently special interest in enforcing hospital directors' fiduciary duties to manage hospital funds appropriately).

203. *See id.* (concluding, without explanation, that patients had a sufficient interest in the financial management of the hospital).

204. *See O'Donnell*, 646 A.2d at 410 (acknowledging that *Stern* recognized a sufficient special interest in nonprofit enforcement where nonmember parties were "contributors, . . . [and] users or buyers of . . . goods or services").

205. *See Christiansen*, 683 F.2d at 527 (noting that *Stern* was "novel precedent . . . representing the outer limits" of nonprofit director liability) (citations omitted); *O'Donnell*, 646 A.2d at 410 (labeling *Stern*'s holding as the "apogee" of relevant case law and a factual extreme).

result, yet neither has explicitly disavowed *Stern*'s central holding.[206] Yet even in *Christiansen v. National Savings & Trust Company* and *O'Donnell v. Sartegna*, the courts did not find *Stern's* outcome or reasoning incorrect; they simply refused to apply *Stern* by distinguishing the facts of their cases.[207]

In *Christiansen*, federal employee health insurance plan subscribers brought claims of maladministration against the insurance provider.[208] The D.C. Circuit Court of Appeals, which had the power to overturn *Stern's* holding, did not do so.[209] Instead, the court of appeals considered and further explained *Stern*'s reasoning.[210] According to *Christiansen*, the *Stern* decision was premised mainly on the fact that enforcement of the hospital directors' fiduciary duties was left solely to the patients; no one else existed to hold the nonprofit directors accountable.[211] The *Christiansen* court then distinguished its facts from *Stern*, noting that a more closely related and directly injured party existed to litigate the alleged malfeasance in the case of the insurance provider.[212]

Similarly, the *O'Donnell* court questioned *Stern*[213] and distinguished the case on factual grounds without discounting *Stern*'s legal reasoning.[214] In *O'Donnell*, the Maryland Court of Appeals refused to apply *Stern* to allow nonmember healthcare plan subscribers to bring derivative claims against plan administrators.[215] Although the

206. *See Christiansen*, 683 F.2d at 528-29 (narrowly interpreting *Stern* as providing no authority for the proposition that nonprofit corporations owe fiduciary duties directly to nonmembers); *O'Donnell*, 646 A.2d at 410 (distinguishing the "self-perpetuating board" and the absence of regulation in *Stern* from the facts in *O'Donnell*); FREMONT-SMITH, *supra* note 3, at 330 (noting the importance of *Christiansen* as a critique and explanation of *Stern*, not an outright invalidation of its holding).

207. *See Christiansen*, 683 F.2d at 529 (distinguishing its facts *Stern* by noting that "*Stern* does not support the proposition that nonprofit corporate entities owe a fiduciary duty to plaintiffs as subscribers"); FREMONT-SMITH, *supra* note 3, at 329-30 (explaining the *Christiansen* court's refusal to apply *Stern* because the plaintiffs there used *Stern* only to establish that the nonprofit healthcare insurer owed fiduciary duties directly to the subscribers). Similarly, the *O'Donnell* court questioned the *Stern* rationale, but ultimately distinguished *Stern* on factual grounds. *O'Donnell*, 646 A.2d at 410.

208. *Christiansen*, 683 F.2d at 521.

209. *Id.* at 529.

210. *See id.* at 527-28 (considering, in-depth, the impact of *Stern*'s reasoning to the instant case).

211. *Id.* at 528.

212. *Id.* at 528-29.

213. O'Donnell v. Sardegna, 646 A.2d 398, 408-09 (Md. 1994).

214. *See id.* at 410 (indicating that the self-perpetuating nature of the board in *Stern* and the absence of close public regulation or financial filing responsibility in that case sufficiently distinguished *Stern* from *O'Donnell* to justify a denial of standing).

215. *Id.*

plaintiffs in both the *Stern* and the *O'Donnell* cases were consumers of nonprofit services,[216] the *O'Donnell* court distinguished the cases because the levels of official regulation imposed on the nonprofit defendants were substantially different.[217] Unlike *Stern*'s Sibley Hospital, the nonprofit healthcare provider under attack in *O'Donnell* was under "considerable statutory and administrative regulation," and thus, other enforcement mechanisms existed to monitor any maladministration.[218] Since other regulation and effective enforcement of the plan administrators' fiduciary duties existed, there was no need to stretch nonprofit corporate law to allow this private party litigation.[219]

Importantly for student derivative actions, *O'Donnell* does not preclude nonmember standing in all nonprofit derivative cases. There the court found only that a mere consumer or contributor relationship was not an adequate basis for allowing derivative suits.[220] Since the relationship between students and universities is more substantial than that between consumers and service providers, students have a stronger argument for nonmember derivative standing than the plaintiffs in *Stern*, *Christiansen*, and *O'Donnell*.[221]

216. *See id.* at 402-03 (describing plaintiffs as "essentially . . . customers, because (1) they have no equity interest in [the corporation's] long term success, and (2) lacking any voting power, they have no say in corporate governance").

217. *See id.* at 410-11 (discussing at length the numerous agencies that directly monitor the healthcare plan provider, including the Maryland Commissioner of Insurance, the Department of Assessments and Taxation, and the Attorney General); *cf.* Christiansen v. Nat'l Sav. & Trust Co., 683 F.2d 520, 528-29 (D.C. Cir. 1982) (pointing out *Stern*'s reliance on the lack of other public regulation to grant standing).

218. *O'Donnell*, 646 A.2d at 410.

219. *Id.* at 411. The *O'Donnell* court also refused to recognize standing for plan subscribers because doing so would require "a very expansive construction" of Maryland's corporation statutes and create the potential for vexatious suits. *Id.* The Maryland Nonprofit Corporation law, however, is not modeled after the RMNCA. FREMONT-SMITH, *supra* note 3, at app. tbl.3. Therefore, *O'Donnell*'s interpretation of the extent of the member derivative suit is not necessarily controlling in those jurisdictions that have adopted the RMNCA. In fact, while prevention of frivolous nonprofit litigation is a legitimate policy goal, the RMNCA member derivative suit provisions suggest an expansion, not contraction, of private party enforcement in appropriate cases. *See* Moody, *supra* note 48, at 271 ("More than any other part of the [RMNCA], the provisions with respect to membership are enabling.").

220. *See O'Donnell*, 646 A.2d at 410 ("We are not persuaded that standing to sue derivatively officers and directors of a nonprofit corporation should be extended to nonmembers, based on their status as contributors to the corporation or as users or buyers of its goods or services.").

221. *See infra* Part III.B (applying *Stern*'s reasoning to the case of university students seeking to assert derivative rights in the university).

### B. *University Students Have a Strong Case for Derivative Standing Under* Stern

The central holding of *Stern*, which allowed nonmembers to bring a derivative action against a nonprofit corporation, has not been overturned.[222] As applied in the context of university students, *Stern*'s outcome provides a new opportunity for students to demand the accountability of those who control their educational investments. University students seeking to enforce the fiduciary duties of college presidents and trustees satisfy each of the four factors under the *Stern* test and, in fact, present a more compelling and less extreme claim to nonmember derivative standing than the *Stern* patients.[223]

University students meet the first *Stern* factor because private university boards are typically self-perpetuating.[224] Just as the Sibley Hospital board in *Stern* was self-selecting, university boards of trustees are held to lesser checks on accountability because they are not subject to popular election.[225] Since they lack internal democratic checks on trustee conduct, self-perpetuating college boards are more susceptible to fiduciary breach, and according to *Stern's* reasoning, present a greater need for private party enforcement.[226]

Likewise, private university students meet *Stern's* second factor because the operation of private universities and the fiduciary duties of school leaders are not closely regulated by any public authority.[227] Attorneys general do have charitable enforcement authority over universities,[228] but recurring college scandals[229] and critiques of

222. *See supra* Part III.A (discussing subsequent judicial interpretation and critique of the *Stern* holding).
223. *See supra* Part III.A (outlining the four *Stern* factors and discussing courts' interpretations of *Stern* as applied to standing of nonmembers).
224. The self-perpetuating nature of nonprofit, private university trusteeship is a "time-honored concept," despite suggestions for expanding control of the university board. *See* Rauh, *supra* note 175, at 440-41 (noting the prevalence of the self-perpetuating university board of trustees, and urging the empowerment of other university constituencies, like students and faculty, to participate in university governance); *see also* LOMBARDI ET AL., *supra* note 129, at 5-7 (explaining the widespread use of a self-perpetuating university board of trustees).
225. *Cf.* Dimieri & Weiner, *supra* note 113, at 1047-48 (discussing the importance of a third nonprofit membership group in the corporate design for balancing the power structure and ensuring accountability and proper conduct by nonprofit managers and directors).
226. *Cf. id.* (discussing the increased chance of misconduct or self-dealing where a self-perpetuating board is used); *Stern II*, 381 F. Supp. 1003, 1019 (D.C. Cir. 1974) (listing the presence of a self-perpetuating board as one factor justifying private party enforcement of nonprofit fiduciary duties).
227. *See supra* Part III.A (listing the lack of public oversight as a main concern of the *Stern* and *O'Donnell* courts).
228. *See* Blasko ET AL., *supra* note 18, at 41 (explaining that attorneys general have a "preclusive power of enforcement" in university student and other charitable enforcement cases, which as a general rule disallows private enforcement).

charitable enforcement indicate that the adequacy of this oversight is doubtful.[230] Thus, although universities are technically regulated by a public official, this regulation is in name only, and does not provide meaningful enforcement of the administrators' fiduciary duties.[231] Importantly, the same attorney general enforcement applied to the Sibley Hospital in *Stern*, yet the court still held that private party enforcement was appropriate under the circumstances.[232] Moreover, unlike the healthcare nonprofit corporations in *O'Donnell* and *Christiansen*, which are heavily regulated at the state level, private universities enjoy a relative freedom from state or federal oversight into their operations.[233]

University students also meet the third *Stern* factor because, much like Sibley Hospital, private universities are not required to file financial reports with any public agency.[234] Again, the assumption is that less disclosure increases the need for effective external enforcement mechanisms such as private party derivative suits.

Finally, the argument for university students' nonmember derivate standing is strongest under *Stern's* fourth requirement that students hold a sufficiently special interest in the university.[235] Under *Stern*, students qualify for nonmember derivative standing against the university because their interest in university administrator fiduciary

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229. *See supra* notes 7-15 and accompanying text (discussing the presidential scandals at American and Adelphi Universities).

230. *See supra* Part I.C.1 (summarizing scholarly assessment of the failure of attorney general charitable enforcement).

231. *See Stern II*, 381 F. Supp. 1003, 1019 (D.D.C. 1974) (implicitly denying that attorney general enforcement is adequate public oversight by stating that the nonprofit hospital, under the enforcement authority of the attorney general, was "not closely regulated"); *see also* O'Donnell v. Sardegna, 646 A.2d 398, 410-11 (Md. 1994) (finding public oversight was adequate where enforcement was carried out by multiple agencies in addition to the attorney general).

232. *See generally Stern I*, 367 F. Supp. 536 (D.D.C. 1973) (allowing interested private parties to proceed with an enforcement action against the nonprofit hospital, despite the attorney general's enforcement role).

233. *Cf. O'Donnell*, 646 A.2d at 410-11 (listing a number of state agencies that have the power to investigate, oversee, and ensure the proper operations of the health insurance plan provider).

234. There is currently no widespread system of nonprofit financial oversight besides reporting to the IRS for tax exemption. *Cf.* Reiser, *There Ought to Be a Law*, *supra* note 3, at 562-68 (discussing the recent movement to experiment with nonprofit financial disclosure requirements at the state level, reflecting the past system of non-disclosure). However, Sibley Hospital was under the same obligation to make IRS filings as private universities, and the *Stern* court did not consider this reporting adequate financial disclosure. *See Stern II*, 381 F. Supp. at 1019.

235. *See Stern I*, 367 F. Supp. at 538-40 (finding that Sibley Hospital patients held a sufficiently special interest as former customers of nonprofit hospital services, despite the fact that their losses resulting from hospital mismanagement were indirect and remote); *see also supra* Part III.A (examining *Stern*'s "special interest" finding in relation to the former patients).

enforcement is more substantial than that held by the *Stern*, *Christiansen*, or *O'Donnell* plaintiffs.[236]

*Stern* found that former patients of Sibley Hospital, as mere purchasers of nonprofit services, held a sufficient special interest in enforcing the proper management of the hospital's charitable assets.[237] *Stern*'s weakness was that it failed to explain or support its conclusion that these former consumers held a sufficiently special interest in the hospital's function.[238] Yet this factual weakness is greatly lessened in the case of university students. Logically, if former patients—mere consumers—held a derivative interest in the hospital, then other nonprofit participants with relationships more closely resembling membership should also be able to assert derivative claims against nonprofit corporations. Private universities operate in reality much like member nonprofit corporations despite their technical lack of members,[239] and students play a role within the university very similar to that of nonprofit members.[240] Since students are more analogous to recognized members than nonprofit consumers, students' interests in nonmember derivative standing not only meet, but surpass, the fourth *Stern* factor.

### 1. *Private universities function as member nonprofit corporations despite their nonmember legal structure*

Several scholars suggest that effective enforcement of any particular charitable institution requires a response tailored specifically to the purposes it serves in society.[241] Specifically, they argue for enforcement schemes that distinguish between member-

236. Plaintiffs in each of these cases were consumers or former consumers. *See* Christiansen v. Nat'l Sav. & Trust Co., 683 F.2d 520, 521 (D.C. Cir. 1982) (examining a claim by plaintiffs who were healthcare insurance plan subscribers); *Stern I*, 367 F. Supp. at 536 (involving plaintiffs who were former hospital patients); *O'Donnell*, 646 A.2d at 399 (describing plaintiffs who were healthcare insurance plan subscribers).

237. *See Stern I*, 367 F. Supp. at 538, 540 (describing the former patients' interests in antitrust claims as too remote and indirect, then concluding abruptly that "[p]laintiffs unquestionably" had a sufficient special interest in the enforcement of hospital director fiduciary duties).

238. *See Christiansen*, 683 F.2d at 527 (explaining that the *Stern* special interest holding contained less analysis than that of plaintiffs' antitrust standing).

239. *See infra* Part III.B.1 (describing the functional reality of private universities as corporations which primarily serve enrolled students).

240. *See infra* Part III.B.2 (comparing the roles, rights, and expectations of university students and nonprofit members).

241. *See, e.g.*, Atkinson, *supra* note 117, at 660 ("[C]harities are not the whole of the nonprofit sector. Even within that sector, important differences between organizations may necessitate different criteria for standing to sue the organizations' fiduciaries."); Fishman, *supra* note 33, at 683 ("[A]ttention must be given to the realities of nonprofit corporation governance and the development of alternative approaches to the effective monitoring of nonprofits' performance.").

oriented organizations and "traditional," donor-dependent charities.[242] They argue that private party standing to bring derivative actions should depend on the corporation's primary purpose[243] and the sources of its income,[244] not upon the optional recognition of members in its organizational documents.[245] Under this rationale, private universities should be treated as member nonprofit corporations for enforcement purposes, despite their technical nonmember status, due to their student-centered educational purposes and tuition-based funding.[246]

Private universities serve the general public by supplementing public education, research, academic exploration, and the advancement of general social knowledge. However, the primary purpose of a private university is to educate currently-enrolled students who have paid tuition.[247] In addition, universities derive a

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242. Hansmann's typology, which divides nonprofit corporations into donative, commercial, mutual, and entrepreneurial organizations, demonstrates that some nonprofit charities do not fill the traditional role of meeting social welfare needs. *See* Hansmann, *supra* note 4, at 502-04 (analyzing the essential features and appropriate role of nonprofit organizations). Instead, he argues that some nonprofits are organized specifically to meet "contract failures" where the market economy does not provide products or services to the full satisfaction of consumers. *Id.* at 506-07. According to Avner Ben-Ner, the purposes and operation of many charities are not actually charitable because they do not provide support services to the needy populations. *See* Ben-Ner, *supra*, note 42, at 732-34 (reviewing the proposition that nonprofit organizations often participate in activities that are unrelated to their charitable missions and that executives of nonprofits misuse the organizations' resources). He suggests, therefore, that the true beneficiaries and those most interested in enforcement are determined by examining the source of the organization's funding. *Id.*; *see also* Atkinson, *supra* note 117, at 660 ("[D]ifferences between charitable organizations and mutual benefit organizations are particularly important [for enforcement purposes].").

243. *Cf.* Hansmann, *supra* note 4, at 553-60 (discussing the purposes, roles, and different problems that arise in the context of member-oriented nonprofit corporations); Atkinson, *supra* note 117, at 660 (cautioning that within the nonprofit sector, there are important differences between organizations that may require different criteria for standing).

244. *Cf.* Ben-Ner, *supra* note 42, at 735 ("[T]hose who have an economic demand for the nonprofit form [those actually receiving benefits from the nonprofit corporation] are in the best position to ensure [effective nonprofit operation]."); Hansmann, *supra* note 4, at 502-03 (positing that the private parties who fund member-oriented nonprofit corporations, what he calls "patrons," should have standing to bring derivative actions to increase the effectiveness of nonprofit enforcement).

245. *Compare* Ben-Ner, *supra* note 42, at 735 (arguing that private enforcement by interested consumers of nonprofit services creates an economic demand that best ensures accountability) *with* REVISED MODEL NONPROFIT CORP. ACT § 6.30 (1987) (proposing derivative litigation rights for recognized members only, regardless of the economic demand for such enforcement).

246. *See supra* Part II.A (discussing the legal forms of private universities as nonmember nonprofits).

247. *See infra* Part III.B.2 (discussing students' interest in the continued success of the organization).

large percentage of their operating income from student tuition and fees.[248] Universities may utilize alumni and other donations, but the sheer percentage of operating income derived from tuition makes it clear that universities depend mainly on student payments for funding.[249] Together these two factors show that private universities, despite their technical legal classification as nonmember nonprofit corporations, fit more accurately under the label of membership nonprofits.[250]

2. *University students are more analogous to nonprofit members*

Assuming that private universities operate as member nonprofits, students are the most natural constituents to serve as members of the corporate university. Students and nonprofit members share similar expectations, roles, obligations, rights, privileges, and interests in their respective organizations.[251] These shared characteristics make the student-university relationship much more analogous to membership than the patient-hospital relationship in *Stern*.[252] Therefore, courts should recognize students' sufficient special interest in private universities and grant them nonmember derivative standing to supplement attorney general enforcement.

Nonprofit members and students share similar expectations, goals, and motivations for associating with their respective organizations. Like members who join nonprofit organizations to meet a particular need unmet in the marketplace,[253] students attend private universities to obtain an education that they believe is not available in public

248. In 2001-2002, student tuition and fees accounted for approximately forty percent total income for private degree-granting institutions. EDUCATION STATISTICS, *supra* note 19.

249. *Cf. id.* (listing the amount of private university income received from all funding sources and showing that student tuition provides the largest source of private university funding comparatively).

250. Recognition of private universities as membership nonprofits does not upset the system of nonprofit classification under the RMNCA. While educational institutions typically incorporate as public benefit organizations, *see* Reiser, *Dismembering Civil Society*, *supra* note 114, at 839, these public benefit corporations still have the option to create a class of members. *Cf.* REVISED MODEL NONPROFIT CORP. ACT §§ 1.40(28), 17.07(3) (1987) (defining and setting forth requirements of establishing a public benefit corporation).

251. *See infra* Part III.B.2 (positing that students actively contribute to the university community by attending classes and participating in campus activities).

252. *See Stern I*, 367 F. Supp. 536, 536-37 (D.D.C. 1973) (plaintiffs are former patients, of the Sibley Hospital with no other ties to the nonprofit organization); *cf.* O'Donnell v. Sardegna, 646 A.2d 398, 410 (Md. 1994) (categorizing the *Stern* patients as mere purchasers of hospital services).

253. *See* Hansmann, *supra* note 4, at 506-07 (explaining that most member-oriented nonprofit corporations organize to meet the needs of consumers who are dissatisfied with the products or services that the market offers).

institutions.[254] Both groups join because it will serve their particular needs.[255] Furthermore, since members and students are both dependent on these nonprofits for important services, they are both interested in the organizations' continued success as they receive secondary benefits from such success.[256]

Characterizations of the legal relationships and obligations between nonprofit and member and university and student are also strikingly similar. Just as nonprofit members' and shareholders' relationships to their corporate organizations,[257] courts have often described the university-student relationship as a contractual one.[258] Both groups gain membership or admittance only after meeting the restrictive admission requirements set by the organizations themselves.[259] In addition, most members pay initial and periodic nonprofit membership fees, while students pay tuition and student fees in order to enroll. Further, neither the obligations and privileges arising from membership nor student enrollment are freely transferable at the option of the member or student; nonprofit membership, like student attendance, is unique and personal.[260]

254. *Cf. id.* (observing that complex personal services like education often cannot be adequately evaluated by purchasers, and therefore, students may prefer the nonprofit (private) provision of educational services to account for this market "contract failure").

255. *Cf.* Ben-Ner, *supra* note 42, at 734 (identifying consumer dissatisfaction with market-provided services as the motivation for seeking nonprofit services); Kent Weeks & Rich Haglund, *Fiduciary Duties Of College And University Faculty And Administrators*, 29 J.C. & U.L. 153, 158 (2002) ("Students at universities depend on the university to help them become educated.").

256. As the goals of a nonprofit corporation are met with increasing effectiveness, members gain from the increased value of those products or services. More specifically in the university context, students gain reputation and career marketability, which comes with an increasingly popular or well-respected university. *Cf.* Steeneck v. Univ. of Bridgeport, No. 93-0133773, 1994 WL 463629, at *4 (Conn. Super. Ct. Aug. 18, 1994) (discussing how students' challenges to university administration demonstrate that students greatly value a school's reputation, and are vastly concerned with the reputation loss that could result from a merger with another school).

257. *See, e.g.*, Brenner v. Powers, 584 N.E.2d 569, 574 (Ind. Ct. App. 1992) (finding that a contractual relationship arises between the organization and the member when nonprofit articles of incorporation recognize members).

258. *See generally* K.B. Melear, *The Contractual Relationship Between Student and Institution: Disciplinary, Academic, and Consumer Contexts*, 30 J.C. & U.L. 175 (2003) (discussing the modern trend of classifying the university-student relationship as primarily contractual in nature).

259. Just as qualifications for membership are outlined by nonprofit incorporators in the articles of incorporation or organization's bylaws, student qualifications for admittance (i.e., high school graduation) are firmly established by university administrators. *See* REVISED MODEL NONPROFIT CORP. ACT §§ 6.01(a), 3.02(15) (1987) (permitting articles or bylaws to create procedures for admitting members and establishing a corporation's general power to set conditions for admission of members).

260. *See* REVISED MODEL NONPROFIT CORP. ACT § 6.11 (restricting members from

Finally, members' and students' interests and investments are both protected by the legal fiduciary obligations that govern nonprofit managers.[261]

Nonprofit members and students also fill similar roles in their organizations as both groups contribute more time, energy, and money over a longer span of time than donors or volunteers.[262] This increased participation in the ongoing operation and development of the nonprofit corporation is an important factor recognized under the RMNCA.[263] Just as members direct nonprofit programs and serve on nonprofit committees, students also actively contribute to the university community by attending classes, performing research assistance, and participating in campus organizations and activities.

A central feature defining nonprofit membership is the enjoyment of privileges and rights that are not available to the general public.[264] Students, like members, gain special rights and privileges upon admittance to the university. For example, upon enrollment, students gain the right to attend classes and earn a degree, privileges to use university facilities like campus sports centers or computer labs, access to career and other counseling, rights to be represented in student government, and the ability to participate in student organizations.[265]

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transferring any interests in the nonprofit unless the corporation itself allows such transfer). Likewise, students cannot transfer their right to attend a university to another potential student at their option. Each student must be admitted on separate consideration by university admissions directors.

261. *See* REVISED MODEL NONPROFIT CORP. ACT § 8.30 (listing fiduciary duties of nonprofit directors to the corporation); *cf.* Weeks & Haglund, *supra* note 255, at 154-55, 173 (arguing that university administrators owe a fiduciary duty directly to students in certain situations including the management of tuition funds).

262. *Cf.* Reiser, *Dismembering Civil Society*, *supra* note 114, at 852 (examining the more involved role of members as decision-makers or monitors/enforcers, but noting that volunteers and donors can be admitted as members to an organization). *See generally* Dimieri & Weiner, *supra* note 115 (discussing member involvement including exerting influence and control over the nonprofit board of directors).

263. *Cf.* Moody, *supra* note 48, at 270-71 (discussing the RMNCA's focus on member participation as the basis for membership rights, which signals a shift away from the classic shareholder equity ownership model).

264. Nonprofit membership can include special privileges such as member discounts, access to organizational information, opportunities to participate personally in the operations of the organization through service on organizational committees or boards, and voting rights to control the mission and goals of the organization. *See* Reiser, *Dismembering Civil Society*, *supra* note 114, at 273. The most important of these rights under the RMNCA, is of course, voting. *See* REVISED MODEL NONPROFIT CORP. ACT §§ 7.20-7.30 (outlining provisions setting forth specific procedures for member voting, implying the importance of member involvement and interaction).

265. *Cf.* Melear, *supra* note 258 (detailing the various contexts in which students have sought legal enforcement of educational contract rights, including disciplinary proceedings and educational program terminations).

Nonprofit members and students clearly differ in the voting rights they hold in their organizations. Members, as defined in the RMNCA, are generally entitled to vote in the election of nonprofit directors and to amend the nonprofit articles of incorporation.[266] Typically, university students do not hold similar rights.[267] Despite the centrality of voting rights to the nonprofit membership under the RMNCA, students' lack of voting rights does not necessarily defeat students' analogous role as members in private universities.

Students' lack of formal control in university policymaking may be mitigated by other informal mechanisms by which students influence university decision-making.[268] At some institutions, students can represent their views through honorary or non-voting seats on the board of trustees, participation in formal student governments,[269] or public opposition to university policies in student-run newspapers or demonstrations.[270]

Even the inadequacy of these informal control mechanisms as a replacement for formal voting power may not defeat students' claims to nonprofit membership. As Professor Dana Resier explains,

> [T]he concept of membership need not be entirely static. Nonprofit corporate statutes do define the voting rights of members as a matter of default . . . [but] also permit individual nonprofits to vary member rights from these default positions. Nonprofits who take advantage of this flexibility might create multiple classes of members, some with and some without voting rights, or might limit the actions on which their members will be entitled to vote . . . . This permissive structure allows for endless permutations of the member concept . . . .[271]

Thus, nonprofit corporations could imaginably design a recognized membership that lacks voting rights, yet is still entitled to bring derivative suits in courts of law.[272] University students may be a perfect example of the RMNCA's "design flexibility" that Reiser

266. REVISED MODEL NONPROFIT CORP. ACT § 1.40(21)
267. *See* Rauh, *supra* note 175, at 440-41 (explaining that university boards of trustees are generally self-perpetuating, and trustee selection does not typically include the input or approval of students).
268. *See* D. Bruce Johnstone, *The Student And His Power*, 40 J. HIGHER EDUC. 205, 206-18 (1969) (contending that informal modes of control like student forums, student government, individualized academic plans, and protests against administrators' decisions allow students to exert relatively large amounts of control over university policies).
269. *Id.* at 211-12.
270. *Id.* at 217-18.
271. Reiser, *Dismembering Civil Society*, *supra* note 114, at 840-41.
272. *Cf. id.* (explaining how the flexibility offered to nonprofit incorporators allows for many varying membership classes).

discusses.[273] According to Reiser, knowledgeable nonprofit incorporators could create a student membership closely tailored to allow involvement, investment of time, money, and personal commitment, retention of a continuing interest in the school, and a complete lack of voting rights.[274]

According to this detailed analogy between students and nonprofit members, although students' interests in the university are not technically recognized as nonprofit memberships, they clearly surpass the consumer interest of the *Stern* patients.[275] University students thus meet all four of the *Stern* factors and, under that precedent, qualify for nonmember standing to bring derivative claims against the universities they attend.[276]

### *C. Other Policy Considerations Support Recognizing Student Derivative Suits*

In addition to the legal and factual arguments presented above, several policy considerations also support the recognition of a university student derivative suit. The following arguments are not intended to stand alone to justify students' legal right to bring derivative actions against their universities. However, these policy arguments are an important addition to the debate, and address many of the general objections that courts and commentators have voiced against private charitable enforcement.

#### *1. Derivative litigation accommodates students' lack of extra-judicial methods for protecting their interests*

Students need access to the member derivative suit because their interests and investments in the university are not otherwise protected in any meaningful way.[277] In addition to derivative

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273. *See id.* at 841 (noting that flexibility may allow for the creation of multiple classes of members).

274. *See id.* at 840-41 (commenting on the endless possibilities of corporate structure and membership available to sophisticated nonprofit incorporators).

275. Unlike the *Stern* patients, who were mere purchasers of nonprofit hospital services, students play a more significant role within, and hold a greater interest in, the university. *Cf.* Haskell, *supra* note 6, at 2-3 (noting that universities stand generally in a higher position of trust with their enrolled students); Weeks & Haglund, *supra* note 255, at 158-59 (discussing the increasing trend of courts to recognize the fiduciary, not merely contractual or consumer, relationship between the university and the student).

276. *Cf. Stern I*, 367 F. Supp. 536, 540 (D.D.C. 1973) (allowing former patients of a nonprofit hospital, mere consumers, to bring derivative claims of fiduciary breaches on behalf of the nonprofit hospital, despite their nonmember status).

277. *Cf.* Hansmann, *supra* note 4, at 613 (opining that nonmember constituencies may actually be in greater need of legal standing to sue nonprofits because they lack the other control mechanisms (i.e., voting) that members enjoy).

litigation, shareholders and nonprofit members can exert control over directors and trustees through extra-judicial mechanisms such as voting, selling shares, and market oversight.[278] However, these mechanisms are either unavailable or ineffective for university students. First, students do not have any internal democratic method for controlling the direction of the university.[279] Students are also unable to easily transfer their interest in the university.[280] Finally, the student population is not as capable of exerting political pressure on attorneys general to investigate fraud because they are perceived as politically inactive: many students cannot vote in the state in which they attend school and typically cannot make significant contributions to political campaigns. Since none of these alternatives—voting, transfer, market oversight, or political mobilization—adequately protect student interests, allowance of a student derivative suit will empower students to better protect their substantial educational investments.

2. *Recognizing student derivative rights will not open litigation floodgates against universities*

A primary bar against recognizing student derivative rights is the longstanding floodgates argument.[281] Critics contend that student derivative suits will expose universities to frivolous litigation, unpredictable levels of liability, and ultimately divert funds away from education.[282] Despite the value of this critique, its import to the

278. *See* Reiser, *Dismembering Civil Society*, *supra* note 114, at 837 (noting that shareholders can exert influence and they are "not merely ticket holders in some great corporate lottery").

279. Although students usually enjoy the privilege of voting for student government representatives, students generally have no voting power or other method for exerting control over university trustees. *Cf.* Rauh, *supra* note 175, at 440-41 (urging a change in the university trustee selection process to include the votes of students).

280. Shareholders can utilize the liquidity of their financial investment and sell all interests in a corporation that does not perform to their satisfaction. *See* Reiser, *Dismembering Civil Society*, *supra* note 114, at 837-38 (differentiating nonprofit members from for-profit shareholders who have voting rights and rights of exit that allow them to exert influence on their organizations). Although students can transfer to different schools, the high costs and uncertainty of transferring do not offer significant protection of students' financial and educational investments.

281. Avoiding vexatious litigation is one of the original purposes for placing charitable enforcement powers exclusively in the attorney general. In theory, the attorney general will only pursue legitimate claims and therefore preserve charitable funds for their maximum charitable use. *See* Fishman, *supra* note 33, at 670 (rationalizing the attorney general's role as necessary because property is devoted to accomplish purposes that are beneficial to the community at large, which is a shifting class).

282. *See, e.g.*, Russell v. Yale Univ., No. 970400425, 1997 WL 809974, at *2 (Conn. Super. Ct. Dec. 31, 1997) (denying student standing in part to protect universities

university context may be overstated. Several factors serve as natural "flood gatekeepers" in the university student setting, and therefore reduce the risk of overwhelming amounts of university student litigation.

Some of these limitations arise from the very nature of the student class and students' interests in the university. Students generally lack the financial ability and incentive to pursue private action against university administrators unless the suit is truly warranted and important to the student body.[283] Also, the limited number of years in which individuals actually hold student interests acts as a major barrier to student litigation.[284] The nature of derivative relief also limits students' incentives to litigate. Since derivative damages go directly to the school and students receive no direct personal benefit from the recovery,[285] students are unlikely to invest their own time and funds into litigating frivolous matters. Students, by this logic, will only pursue those suits with a high chance of success and remedies large enough to make a sizable impact on campus.

Other external limitations are also available. Courts can borrow procedural limitations from shareholder derivative suits to weed out unnecessary student litigation.[286] For example, the demand requirement[287] and the posting of security bonds[288] have effectively

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from litigation and limit the power of small interest groups within the university community to veto necessary administrative decisions).

283. *See supra* Part III.B.2 (arguing that students have little incentive to litigate because derivative damages go directly to the school).

284. The number of students who remain enrolled throughout the case, remain personally interested enough to commence private litigation, and are capable of financing litigation is very low, and therefore very unlikely to cause a great flood of private litigation for universities.

285. *See* Goldschmid, *supra* note 3, at 652 (arguing that nonprofit corporations themselves should receive remedies from donor, member, and beneficiary derivative actions, much like the remedies in shareholder derivative suits).

286. Well-developed procedures from corporate law could easily be translated into the university setting and would provide even more control over the perceived flood of litigation against universities. *Cf.* Boykin, *supra* note 46, at 1011-12 (discussing the possible drawback of member "strike suits" and arguing that statutory limitations on member qualification to bring a suit can be modeled after the corporate derivative suit requirements to limit vexatious litigation).

287. The universal demand requirement, an initial hurdle for shareholder derivative claims, is a particularly useful device for curtailing frivolous shareholder claims and promoting internal democratic or market resolution of corporate conflict. Under the ALI Principles, before commencing with litigation, shareholder plaintiffs must demand legal action by the corporation, or else their derivative claim will be dismissed. *See* American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations*, 2 A.L.I. § 7.03(a) (1994) (focusing on the requirement of exhaustion of intra-corporate remedies in a derivative action and mandating that a holder or director make a written demand upon a board of directors, requesting it to prosecute an action or make a suitable correction). Delaware corporate law also requires shareholder-litigants to make a demand for action upon the corporation, or to be excused from making that demand by showing the utter futility of the action.

minimized frivolous litigation in the business context. Also, under the RMNCA, students would not be able to initiate a derivative suit unless they were able to solicit the approval of a certain percentage of fellow members of the student body.[289] In this way, stringent procedural rules will ensure that derivative suits are not used lightly or prematurely.[290]

## CONCLUSION

The recent allegations against former American University president Benjamin Ladner vividly demonstrate that attorneys general have failed to ensure accountability in private universities. Despite the success of private enforcement in other nonprofit settings, courts have historically kept this opportunity from students by denying their standing to raise claims of managerial impropriety against university administrators. Under the special interest doctrine, students fail because they are an amorphous, fluctuating class whose interests and injury arising from mismanagement are indirect. Students are also barred from bringing nonprofit member derivative suits by the technical statutory requirement that they be recognized members under university charters.

Yet under the reasoning of *Stern v. Lucy Webb Hayes National Training School*, private university students have a compelling argument for their right to bring derivative suits against self-dealing college administrators. Although not technically members, students hold interests, roles, relationships, and privileges in the university setting that are closely analogous to those of nonprofit members. In addition, the need for supplemental enforcement in the private university setting is great, and students' power to hold universities accountable through other means is practically non-existent. Under *Stern*, the student relationship and the obvious lack of public oversight of private universities supports the conclusion that students, even more than the *Stern* patients, are entitled to assert derivative

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*See* Zapata Corp. v. Maldonado, 430 A.2d 779, 780 (Del. 1981) (discussing a stockholder's argument that demand was futile because all of the directors were named as defendants and were allegedly involved in the acts specified).

288. *See* Boykin, *supra* note 46, at 1011-12 (noting the member security bond as a possible procedural limitation yet finding that the RMNCA five percent rule adequately filters nuisance litigation).

289. The RMNCA hinges the right of members to sue derivatively on his or her ability to muster approval of the suit by five percent of the voting membership or fifty members, whichever is lower. REVISED MODEL NONPROFIT CORP. ACT § 6.30(a)(1) (1987).

290. *See* REVISED MODEL NONPROFIT CORP. ACT § 6.30 cmt. 1 (noting that the use of procedural limitations can effectively prevent "strike suits").

claims against the university. Courts therefore should extend the statutory and common law right of the member derivative suit to university students.