Duty of Obedience: A Medieval Explanation for Modern Nonprofit Governance Accountability

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PART ONE: INTRODUCTION

The United States "boasts the largest nonprofit sector in the world,"¹ which has often been referred to as the "invisible sector,"² and as "perhaps the biggest unknown success story in American history."³ The nonprofit sector, especially those public benefit

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³ Id. at 1. O'Neill quotes historian Richard Lyman as the source for this comment.
charitable corporations\textsuperscript{4} enjoying federal tax exempt status as 501(c)(3) corporations,\textsuperscript{5} has become less invisible. Unfortunately, the success of public benefit charitable corporations has been overshadowed by scandal.\textsuperscript{6} These scandals have contributed to public skepticism concerning the effectiveness of the substantial benefit the public actually receives from the activities of these corporations—the \textit{raison d'être} of privileged tax exempt status. In short, the public benefit charitable sector is “plagued by a ‘dangerous crisis of confidence’ that stems from a financial and economic crisis as well as a crisis in effectiveness.”\textsuperscript{7}

While there is much debate over how to improve the “transparency and accountability”\textsuperscript{8} of the sector, there is consensus that accountability is necessary. The need for accountability has engendered discussion of various remedies, including the utility of

\begin{itemize}
  \item[] 4. Terminology is a problem in referring to nonprofit, charitable, and exempt corporations. See, e.g., JODY BLAZEK, TAX PLANNING AND COMPLIANCE FOR TAX-EXEMPT ORGANIZATIONS 11 (3d ed. 1999). Though the terms “nonprofit” and “exempt” are often used interchangeably, “nonprofit” is a broad and inclusive category of which “tax exempt” and “charitable” organizations are subsets. The Internal Revenue Code only refers to exempt corporations. See also MARION R. FREMONT-SMITH, GOVERNING NONPROFIT ORGANIZATIONS: FEDERAL AND STATE LAW AND REGULATION 5 (Belknap/Harvard 2004) (citing Lester Salamon’s identification of organizations exempt from taxation under section 501(c)(3) of the Internal Revenue Code as “public-serving” nonprofit organizations and the Independent Sector’s identification of 501(c)(3) organizations as the “independent sector”). This author uses “public benefit charitable exempt corporations” to emphasize all three of these characteristics as follows: serving a broad-based public and operating as a public charity both justify favored tax-exempt status. Sometimes the single term “charitable” or “independent sector” will be used to connote these functional characteristics. When a quoted author uses “nonprofit,” that term will signify a corporation with these characteristics.
  \item[] 6. See Nicole Gilkeson, \textit{For-Profit Scandal in the Nonprofit World: Should States Force Sarbanes-Oxley Provisions onto Nonprofit Corporations?}, 95 GEO. L.J. 831, 832 (2007) (Scandals in the nonprofit sector mirror those in the business sector, such as Enron.). The scrutiny on nonprofits results both from the “halo effect” and from the fallout of the for-profit scandals. Margaret Graham Tebo, \textit{Greater Scrutiny for Nonprofits: Federal Tax Regulations and State Laws Keep a Tight Rein on Tax-Exempt Groups}, 90-Jun A.B.A. J. 51 (June 2004). But see FREMONT-SMITH, supra note 4, at 14. Fremont-Smith and Kosuras conducted a study in 2003 and found that 152 in a universe of 1.4 million organizations had evidence of fiduciaries guilty of criminal and civil wrong doing. \textit{Id.}
\end{itemize}
Sarbanes Oxley-type legislation for nonprofits and accountability for violations of fiduciary duties, without which the law is merely aspirational. Other commentators focus on director independence in the board room and establishing fiduciary duties for the directors of parent holding companies because of potential conflicts of interests arising from overlapping boards in related corporations. In addition, the Internal Revenue Service’s Form 990—“Return of Organizations Exempt From Income Tax”—is another method of providing publicly available information concerning, in addition to financial information, information on “exempt purpose achievements in a clear and concise manner”—including “achievements that are not measurable.” The need for transparency and accountability has also sparked a discussion of the scope and the nature of the fiduciary duties of directors of public benefit charitable corporations.

The Proposed Principles of the Law of Nonprofit Organizations of the American Law Institute (ALI Principles) include the duty of care and the duty of loyalty, but do not employ the language of a separate duty of obedience. Evelyn Brody, the reporter for the revision of the ALI Principles, concludes that “[t]he law imposes on fiduciaries only the twin duties of loyalty and care.”


duty of care and the duty of loyalty. 18 There is, however, less support among commentators concerning the necessity to reference a separate duty of obedience for directors of public benefit charitable corporations.

Some commentators suggest that the duty of obedience is subsumed in the general duty of care. 19 Another group continues to identify a separate articulation of the duty of obedience for public benefit charitable corporations. 20 According to one commentator in the latter group, two states appear to have taken a strict interpretation of a separate duty of obedience and others are "on the cusp." 21

This article presents a rationale for the necessity and value of a separately articulated duty of obedience. Without a duty of obedience, the public benefit charitable corporation director has no duty that is unique and defined substantially differently from his or her colleagues in the for-profit sector, even though he or she directs the use of assets dedicated to charity. Since the duty of obedience is not stated separately from the duties of care and loyalty, it is not surprising that "most commentators argue that the application of the business judgment rule to the decisions of nonprofit directors is justified." 22 However, other scholars continue to debate the appropriateness of this standard. 23 In fact and in perception, the charitable corporation and the business corporation begin


19. E.g., Goldschmid, supra note 11, at 641; Brody, supra note 10, at 1475; Reiser, supra note 13, at 997-98.


21. Huberfeld, supra note 20, at 703 n.89.

22. FREMONT-SMITH, supra note 4, at 210.

23. See, e.g., Boyd, supra note 15, at 744 (arguing for a trustee standard if no members in a public benefit corporation); James J. Fishman, The Development of Nonprofit Corporation Law and An Agenda For Reform, 34 Emory L.J. 617, 676 (arguing that application of business corporate standards to all kinds of nonprofits may be too lenient); Ping Lee, supra note 10, at 927 (arguing against application of business judgment rule).
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to look and act like each other, regardless of rhetoric and tax status. If, in fact, the public benefit charitable corporation looks, acts, and is governed by the same duties as its for-profit counterpart, it is not long before it may be treated like its for-profit counterpart, especially given the wealth and impact of large charitable corporations.

This author believes in the value of the past and present performance of most charitable corporations. Nonetheless, the long-term viability of the public policy of tax exemption is at risk. For this author, the risk is really a crisis of credibility—specifically, whether the presence of the public benefit charitable corporation in a community provides any added value compared to the same services offered by for-profit corporations.

It is self-evident that the activities in § 501(c)(3)—religion, education, charity including health services, etc.—are valuable to a community. The critical issue is whether public charitable tax exempt corporations, by performing these activities, provide added value to the public, as compared to their for-profit counterparts. Good behavior of directors, careful and loyal—at least to the degree of their colleagues in the for-profit sector—does not necessarily meet the legitimate expectations of the public regarding the added community benefits of public benefit charitable tax exempt corporations. The claims of the value of the independent sector to civil society and the justification of the privileged tax status become less credible when the corporate culture, the duties of direc-

24. See Fishman, supra note 20, at 220 ("Virtually all non profits have emulated for-profit firms in their efforts to generate earned income."). See also Letter from Max Baucus and Charles E. Grassley, United States Senate Committee on Finance, to Henry Paulson, Secretary of Treasury, at 3 (May 29, 2007), http://www.senate.gov/~finance/press/Bpress/2007press/prb052907.pdf (last visited March 18, 2008) [hereinafter Baucus/Grassley Letter] (requesting information concerning information on hospitals' executive compensation—as "some charities are as creative as for-profit entities in providing compensation"—as well as information on their billing and debt collection procedures).


26. See Baucus/Grassley Letter, supra note 24, at 1 ("It's important to ensure, however, that these organizations receiving tax-exempt status earn it on a daily basis, and keep their activities and policies in line with the special status conferred on them by the tax code.").

tors, and the effect of the activities of the charitable corporations in the community are not substantially different from those of for-profit corporations performing the same activities. The public expects different benefits to the community from the public benefit charitable corporation. 28

1. The Duty of Obedience is the Distinctive Aspect of the Conduct of Business in a Charitable Corporation

All of the proposed remedies to address recent scandals and to encourage better governance of the charitable sector have merit. However, the thesis of this article is that the proposed remedies, as necessary as they are, will not be sufficient to enhance the long-term credibility of the charitable sector. The duty of care and the duty of loyalty are minimal requirements, not addressing the affirmative use of charitable assets. Without being grounded in an articulated duty of obedience, the duty of care and the duty of loyalty will not be able to sustain the utility, credibility, and accountability requirements of the charitable sector. This is especially true if, as this author believes, the public is to enjoy community benefits from charitable corporations that are distinguishable from those of for-profit organizations.

This article proposes that a separate duty of obedience is the more reliable and efficient mechanism for developing a “mind-set” for directors. This “mind-set” will create and maintain a normative corporate culture that not only avoids scandal, but also achieves affirmative benefits for society.

While in agreement with those who argue that it is necessary to define the fiduciary duty of obedience independently of the duties of care and loyalty, this article proposes that the duty of obedience is more than formalistic legal compliance with the statement of purpose and adherence to laws governing the corporation. 29 A definition of the fiduciary duty of obedience will be proposed that subtly defines the relationships between “mission” and “purposes” and between “public benefit” and “benefit to the public.” The “de-

28. See Bjorklund et al., supra note 20, § 10-1 (“Because nonprofit objectives in important respects are fundamentally different from those of profit-making organizations (mission vs. bottom-line objectives) there are distinctive aspects in the way nonprofit boards conduct business.”).

29. See Huberfeld, supra note 20, at 704; Sasso, supra note 7, at 1529; Kurtz, supra note 18, at 85.
sired effect," that is the added value of the public benefit charitable corporation to the public, will be proposed as a statement of the mission of the corporation. The classification and scope of the authorization of activities that achieve the defined mission, the "desired effect" will be used to define the legal purposes of the corporation as stated in the Articles of Incorporation. Each is a distinct aspect of the duty of obedience.

The mission identifies the desired effect of the purpose, or the activities of the corporation. A concrete statement of the desired effect of the authorized activities in the Articles of Incorporation serves as a benchmark for (1) what "bottom line" is acceptable for a public benefit charitable corporation and (2) how that "bottom line" is to be achieved. This articulation of the duty of obedience will provide a context for the standard of care appropriate for directors of a charitable corporation in making difficult business judgments.

A separate duty of obedience that requires an objectively accountable mission for the stated purposes in the Articles of Incorporation provides a more reliable mechanism for meeting the public's expectations of accountability. A duty of obedience that is given primary importance will help to develop an appropriate normative culture in the charitable corporation. It will be helpful for the self-direction and self-regulation of directors. An understanding of the duty of obedience that accurately reflects the mission of the corporation may be useful to courts in adjudicating challenges to fundamental reorganizations and alleged breaches of the duties of care and loyalty. Finally, a separate duty of obedience, as presented here, provides a basis for reasonable flexibility of directors in responding to changing environments and in governing charitable assets.

2. Medieval Explanation of the Logic for a Duty of Obedience

The method used in this article for explaining the logic supporting a separately articulated duty of obedience is based upon St.

30. The "desired effect" is a term of art of the Final Cause in Aquinas' adaptation of the Doctrine of Four Causes developed by Aristotle. This term will be explained in "Final Cause: The Desired Effect," infra Part 2, § 1.1.B.
31. Sasso, supra note 7, at 1545.
32. Fundamental reorganizations in charitable corporations include sales of substantial assets, mergers, consolidations, conversions, and dissolutions.
Thomas Aquinas’ medieval adaptation of Aristotle’s explanatory methodology, known as the Doctrine of the Four Causes (the Doctrine). The Doctrine is used here to provide a logical framework for illustrating the distinct function of a separate duty of obedience and the derivative nature of the duties of care and loyalty.

The development of the rationale for the duty of obedience forms the remainder of this article and is divided into several sections. Section One sets forth a brief description of the Doctrine. Section Two uses the Doctrine to explain the structure of the charitable corporation and the duties of obedience, care, and loyalty of the directors of a public benefit charitable corporation. Section Three uses the two components of the Final Cause of the Doctrine—(1) the “desired effect” of the human actors performing an activity, and (2) the “desired effect” of the activities themselves—to refine the current definitions of the duty of obedience as formalistic legal adherence to specific activities stated in corporate purposes. Section Four illustrates parallels between the meanings of “mission” and “purpose” proposed in this article and contemporary uses of those terms by the American Bar Association, the Internal Revenue Service, and the court in In the Matter of Manhattan Eye, Ear & Throat Hospital v. Spitzer (MEETH). Section Five offers a conclusion that the proposed definition of the duty of obedience is necessary precisely because the charitable corporation needs to change in response to the meaning of “benefit to the public” and society’s evolving notion of charity.

PART TWO: THE NEED FOR A SEPARATELY ARTICULATED DUTY OF OBEDIENCE

Ultimately, it is the duty of obedience that guides the front line actors who create the norms for improving corporate governance internally and for guaranteeing accountability to the public. The duty of obedience engages the will and intellect of directors, who


34. See id. at 40 (“Aristotle gave the Doctrine its classical formulation though, of course, he used ideas from previous thinkers.”).


36. See BLAZEK, supra note 4, at 26; FREMONT-SMITH, supra note 4, at 48.
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are necessary to activate and give effect to the charitable assets and thereby to produce the intended benefit to the public. The proposed definition of the duty of obedience can have predictive value for directors who may need to make difficult decisions that may result in fundamental changes to the charitable corporation which they govern. The duty of obedience is necessary to balance the public’s need for accountability of the governance of charitable corporation and the directors’ concurrent need for flexibility in governing corporations in complex, changing environments.

1. The Doctrine of the Four Causes

A. Background and Context of the Four Causes

The purpose of the explanation of the duty of obedience through the following methodology is simply to advance the argument for the need for a separate articulation of a duty of obedience and to illustrate the derivative nature of the duty of care and duty of loyalty in the context of the public benefit charitable corporation. A duty of obedience needs to be articulated by each charitable corporation, and this articulation should take place in the context of the corporation’s definition of its specific mission.37

The philosophical context and the terminology of the Aristotelian-Thomistic Doctrine of Four Causes is, of course, “closely tied in with other distinctive features of Aristotle’s thought, specifically his fundamental contrast between form and matter.”38 “In their metaphysics, something’s ‘form’ is its essence—what makes it it—while matter is simply the stuff that, in fact, takes on and loses different forms.”39 The utility of the Doctrine in the context of this article is in the explanations used to distinguish each Cause which, in turn, will be used to distinguish each fiduciary duty. Recognizing the value of these explanations to illustrate the various fiduciary duties of a director of a public benefit corporation does not require any commitment to a grander philosophical system or legal philosophy. The explanations and distinctions among


each Cause are used to illustrate, by comparison, the defining difference in the functions of each fiduciary duty. For this limited purpose, it is not necessary to adopt the philosophical system or world view of the origin of the Causes.

However, at the outset, it is important to remember that the term “Cause” in the explanatory methodology of the Doctrine is used in a wider sense than the narrow meaning of “cause” as it is commonly used in modern English. Because this article's method of explaining the value of a separate duty of obedience is borrowed from Aristotle and Aquinas, “cause” will be used as it was used by them in framing the four categories of questions and distinctions. “In English the word ‘cause’ would by anyone quite untouched by Aristotelian influences be applied only to the third of the Four Causes, Efficient Cause.”40 However, “cause” in the context of the Doctrine means “any factor that is necessary to bring about an effect through an intrinsic relationship to that effect.”41 Basically, this article will use this meaning of “cause” to show that the duty of obedience, properly understood, is the factor that is necessary to bring about the desired public benefit. This duty has an intrinsic relationship to the intentionality of the actors, and this intrinsic relationship, as long as it remains in the corporation, brings about the desired effect of the charitable corporation.

R.J. Henle writes that Aristotle, and later Saint Thomas Aquinas, presented the Doctrine as a method of explanation.42 “Precisely, because it is a method of explanation, it can be used as a method of defining.”43 In this article, the Doctrine is used because in “focusing upon different sorts of questions and their corresponding answers,”44 the case for the separate and distinct function of the duty of obedience can be made succinctly.

40. A DICTIONARY OF PHILOSOPHY, supra note 38.
41. Henle, supra note 33, at 41 (emphasis added).
42. The following brief description of the Doctrine of the Four Causes relies heavily upon Henle, supra note 33.
43. Henle, supra note 33, at 40.
44. A DICTIONARY OF PHILOSOPHY, supra note 38.
B. An Explanation of the Doctrine of Four Causes: The Watchmaker

Material Cause: The "stuff" of the object being described

Henle uses the example of "an old fashioned watchmaker" to illustrate the distinction in the Four Causes. In his example, Henle begins with the Material Cause. The watchmaker has before him wheels, screws, jewels, springs, etc. This "stuff" does not constitute a watch. But, all of these pieces are necessary to make the watch. When assembled, each piece remains in the result, thus making the reality of the watch. However, each piece individually—or even all the pieces collectively—is not the watch. Rather, the pieces of the watch are the Material Cause of the watch when the material remains in and "causes" the "desired effect" of the watch. That is, each piece brings about the effect of the watch because it has an intrinsic relationship to the telling of time or the decorative purpose of the watch. However, at this point, even if the pieces are assembled to look like a watch, the "desired effect" may not yet be produced because it is not known whether the watch is to be a timepiece or a decorative piece. The reality of the watch is dependent on knowing and willing the "desired effect," which is not yet defined. At this point, all that is known is that there is a heap of pieces that have the potential to make a watch. The next question follows: what's the difference between the heap of materials and the desired effect of the watch?

Formal Cause: The Kind of Thing that it is

Henle answers that it is the structure or the organization—the "form"—of the pieces that makes a watch a specific watch. The specific "form" that the parts take distinguishes them from the heap of "stuff" and from other watches that may be made from the same "stuff." The "form" of the parts is called the "Formal

45. Henle, supra note 33, at 41-43.
46. Id. at 39.
47. Id.
48. Id.
49. Id.
50. Henle, supra note 33, at 39.
51. Id. at 39.
52. Id.
53. Id.
The Formal Cause contributes intrinsically to the effect by being in it and making it to be the kind of thing it is. For example, the watchmaker's design for the watch makes it the kind of thing that it is, and the design remains in the watch. Note that both the Material Cause and Formal Cause are in the effect (the pieces assembled to tell time or to be a decoration) and, in some sense, remain in it. At this point, the essence of the heap of pieces is determined by its form—that is, its Formal Cause. If the form is to tell time, what "effects" the telling of time? Some human activity is necessary.

Efficient Cause: That Which Imparts Effectiveness

The watchmaker is the Primary Efficient Cause because he or she contributes to the watch by doing something. Therefore, the watchmaker, in doing something with the pieces that are both the Material and the Instrumental Efficient Cause of the watch, contributes to the effect by activity. However, the "desired effect" is still not defined, even when something looking like a watch is assembled. To effect, that is, to "cause" the "desired effect," one must understand the Final Cause. The question follows: why is the watchmaker acting, and what is the activity that he or she wants the watch to do? Does the watchmaker want to make money or simply make a watch? Is the watch to tell time or to be simply a decoration? These questions lead to the Final Cause.

Final Cause: The "Desired Effect"

The Final Cause is not necessary to explain acts controlled by nature, geometry, or physics. However, it is essential to describe things subject to change. An intelligent agent, when positing human acts in changing environments, acts for a purpose. The Final Cause, as explained by Henle, is the purpose or the why, that is, the "desired effect" of the watchmaker's actions. The watchmaker can't make the watch without appropriate skills, but ap-

54. Id.
55. Henle, supra note 33, at 43.
56. Id. at 42.
57. Id. at 42, 46.
58. Id. at 42.
59. Id.
60. Henle, supra note 33, at 44.
61. Id. at 42.
62. Id. at 43.
propriate skills do not explain what the actor wants to achieve, nor the effect that is desired for the assembled pieces. This desired effect is essential to the acting of the human agent. The Final Cause contributes to the effect because it is consciously being desired. The Final Cause explains human acts, especially in relationship to things that change.

At the risk of over-simplification, these are the basic elements of each of the Causes. Each Cause may also be subdivided. However, for this analysis, the subdivisions of the Causes, especially the Final Cause, will be discussed in the context of the definition of the duty of obedience, specifically in the development of the distinction between “mission” and “purposes” in the proposed definition of the duty of obedience.

2. Application of the Analogy of the Watchmaker to the Explanation of the Public Benefit Charitable Corporation by the Causes

A. Explanation of the Structure of the Charitable Corporation by the Causes

Charitable Assets: Material Cause

The same assets used by a charitable corporation for a public benefit can also be used for the “desired effect” of producing profit and producing private gain to investors. What contributes to making the assets not just neutral, but the Material Cause of the charitable corporation? In the logic of the Four Causes, part of the answer is the structure, or the form, of the organization of the assets that give them specificity as charitable assets. This structure was explained above as the Formal Cause.

The assets of the public benefit charitable corporation, like the pieces that made up the watch, are intrinsic to and remain in the operation of the charitable corporation. Standing alone, however, the assets are neutral and have no identifying characteristics or self-actuating capacity.

63. Id. at 42.
64. Id.
65. Henle, supra note 33, at 42.
Charitable Corporate Organization and Operations: 
Formal Cause

In the charitable corporation, the extrinsic Formal Cause is the plan of the legislator that creates the intrinsic organization and operational structure of a public charity. This legal status—as a qualifying organization under § 501(c)(3) of the Internal Revenue Code—differentiates its “form,” and thus differentiates its assets from the heap of similar assets used for similar purposes (activities) in a business corporation. The distinctive quality of these assets is that they are irrevocably charitable assets. Further, the “form” imposed by the legislator prohibits private benefit and certain other activities. Though the legislator’s “form” gives a separate indelible identity to the thing described, the form has no capacity to activate itself. Some activity is necessary to effect the plan of the legislator.

Fiduciaries and Charitable Assets: Efficient Cause

In the language of the Four Causes, the total Efficient Cause is divided into two functions. The Primary Efficient Cause is the human actor. The Instrumental Efficient Cause is the assets. The board of directors of the charitable corporation is the Primary Cause which “imparts, as it were, effectiveness to the instrumental cause,” the charitable assets. In turn, “the instrumental cause increases the capability” of the Primary Efficient Cause.

Changes or happenings in the corporation occur through the activity of the directors who deploy the assets. The directors have no capacity to “cause” the “desired effect” of the charitable corporation without the assets. Nor can the charitable effect of the assets be “caused” without the intelligent and willful human acts of the directors. Together, they contribute to the “desired effect”

The following organizations are [exempt from taxation]: . . . (3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, . . . or educational purposes, . . . no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

Id. (emphasis added).
67. Henle, supra note 33, at 44.
68. Id.
through conscious direction of the activities of the corporation. It is the intentionality of the human actors that “causes” or effects the consciously “desired effect” of the essence of the legal form of the assets, which is their charitable dedication and use for public benefit within the authorized activities of the law. 69 Without this human intentionality, the external activities may make the organization look like a public benefit corporation, while in reality it may not be one.

The reason is simply practical. The for-profit and the charitable corporation operate in similar ways: both must make a profit. In order to be successful, the corporation needs to act efficiently and profitably. On this level, the charitable corporation’s use of assets looks like that of its for-profit counterparts. According to Blazek, the “distinguishing characteristic of exempt organizations . . . is the motivation for undertaking the activity . . . . [W]hether the hospital is exempt depends on whether it is promoting the general public’s health, not just [operating] without a profit.” 70

The notions of charity and public benefit are not static. Their meanings evolve according to changing societal needs. 71 The critical defining element of the Efficient Cause is the “desired effect” of the human actors to impart this charitable effectiveness (or public good, such as the promotion of health or education) to the charitable assets. It is important to note that there is a difference between simply desiring that the activity classified as education, health, or charity be done, and desiring an identified effect of those activities on a specific human community.

Mission and Purposes: Final Cause

The Final Cause is the one constant that explains the intrinsic interrelationship among dedicated assets, the formal legal organization of the assets, and the capability of the directors to “cause” the “desired effect” of the charitable assets and the charitable organizational form in a specific community. The assets, the structure, and the actors have an intrinsic, continuing interrelationship to cause the “desired effect” only through the act of the intellect and will of the human agents, the board of directors. The Final Cause has two non-severable but distinct components that are relevant to this analysis. One is the “desired effect,” that is, the

70. BLAZEK, supra note 4, at 10.
71. See id. at 26; FREMONT-SMITH, supra note 4, at 3, 100-101.
purpose, or the "why," of the action of the human agents. The second is the purpose, or the "why," of the "thing done." It is the "desired effect" of the directors, the human agents of the corporation, to "cause," that is to "effect" the benefit to the public, which makes real the *raison d'etre* of the legal form and existence of the public benefit charitable corporation.

The essence of the form of the watch may be to tell time. However, the watchmaker also wants to make money from the watch through its value to tell time. By analogy, the legal essence of the exempt form of the charitable corporation is to perform exempt activities, not for the benefit of the corporation, but for the benefit to the public. This charitable legal form requires intentionality by the human agents, who impart effectiveness to the assets of the charitable corporation to "effect" an intended benefit.

Henle's explanation of the role of the Final Cause in the definition of law is relevant to the legislator's intent in creating the charitable corporation: "[h]uman beings direct their human acts to a Final Cause of private goods of their personal choosing, while law directs certain human acts (positive or negative) to the Final Cause of society, the common good."72 This definition of law is easily applied to the Formal Cause of the public benefit charitable corporation: the legislator has "formed" the essence of public benefit charitable corporation, its assets are dedicated to charitable purposes (as distinguished from private gain), and the corporation operates for the public, not private benefit. Though the terms "common good" or "public benefit" are not used in the 501(c)(3) statutory language, the notion of the "common good" is implied in the legal status of the charitable assets and by the explicit prohibition against private benefit, which is essential to the classification as a charitable corporation.73 The Panel on the Nonprofit Sector convened by the Independent Sector to develop good governance and ethical practices for charitable corporations describes this sector as the "the most widespread organized expression of Americans' dedication to the common good."74 The ultimate "desired effect" of the activities deemed charitable by the legislator is the common good. Some human agent has to will this effect for the charitable corporation and monitor its achievement.

B. Explanation of the Fiduciary Duties of Directors by the Causes

The function of fiduciary duties in a charitable corporation is to create an internal discipline through a statement of duties that moves the actor from the level of efficiency and economic stability (which are instrumental and absolutely necessary values), to the level of naming, implementing, and measuring objectives that "in important respects are fundamentally different from those of profit-making organizations."75

The following explanation of the fiduciary duties of the board of directors of a public benefit charitable corporation is based on the functions of the Four Causes. This explanation helps illustrate the internal logic and necessity of isolating the independent and fundamental function of the duty of obedience. The duties of care and loyalty in a charitable corporation, though intrinsically related to the duty of obedience, are derivative of the duty of obedience. The duties of care and loyalty do not have the power in themselves to engage the same questions as the duty of obedience does if understood in the context of the Final Cause.

In the Cause paradigm, the duty of care and the duty of loyalty actually focus on the "stuff"—i.e., the assets and the legal form of the organization. The legal form deems certain activities exempt and includes the negative prohibitions against private benefit in the legal design of the corporation. 76 This design remains in the corporation and makes it what it is. The "stuff" and its form cannot activate themselves to achieve a desired effect. A desired effect of the charitable corporation is ultimately "caused" by the purpose of the human activity. This purpose is a function of the intellect and an act of the will of the directors who, by their action, activate the legal fiction of the charitable corporation.

Duty of Obedience: "Desired Effect"

Because the charitable corporation cannot activate itself, and because only human agents can impart intrinsically charitable or public benefit effectiveness to the assets of the corporation, the Final Cause illustrates the logical necessity and the fundamental function of a separately recognized fiduciary duty of obedience. The duty of obedience isolates the intentionality of the actors to

75. BJORKLUND ET AL., supra note 20, § 10-1.
name the “desired effect” to be achieved through the proper use of charitable assets. The watchmaker can arrange pieces of a watch skillfully. When the pieces are assembled, the object looks like a watch. If the intention of the watchmaker was to make a timepiece, and the watch looks like a timepiece but is only decorative, the object is not the intended watch. If a charitable corporation is operated skillfully, but the directors do not direct their skillful activity to the “desired effect” of achieving some common good—i.e., to provide charity or a specific benefit to the public—it may be an efficient and economically successful corporation, but it will not achieve the desired effect of a charitable corporation.

Ideally, a charitable corporation’s Articles of Incorporation should describe which of the eight categories in § 501(c)(3) applies to it. Blazek states that a common thread running through the various types of exempt categories is service to a societal or group mission.\textsuperscript{77} Specifically discussing hospitals, Blazek indicates that “[w]hether a hospital is exempt, for example, depends on whether it was created and operated to provide health care \textit{for the purpose of promoting the general public’s health}, not upon a deficiency of patient revenues in comparison to its expenditures.”\textsuperscript{78} While the author’s context is the necessary business-like behavior required of exempt organizations, the point of the activity is promoting a benefit to a societal good, public health. A for-profit hospital may provide the same health services to the community. But, the assumption of a charitable corporation is that it has an affirmative duty to promote effectively the general public’s health.

Several commentators note that the notion of charity, inherent in these categories, evolves to meet societal needs and changing views of public benefit.\textsuperscript{79} The least that can be said of charitable corporations is that they exist to achieve some public purpose. Historically, the charitable sector, through its organizational structure, has provided benefits to the public or the common good of society beyond the delivery of the same services performed by its for-profit counterparts. Some of these historical and societal values are noted in the Preamble to the Independent Sector’s Principles of Good Governance: the charitable sector provides a mechanism for “social cohesion, a laboratory of innovation, and a continually adaptable means of responding to emerging ideas,

\textsuperscript{77} BLAZEK, supra note 4, at 3.
\textsuperscript{78} \textit{Id.} at 10 (emphasis added).
\textsuperscript{79} \textit{See, e.g., id.} at 26; FREMONT-SMITH, supra note 4, at 100-01.
needs, and communal opportunity.” While acknowledging that the “desired effect” of the human agents governing the charitable corporation may be simply to perform the activities of the legal categories stated in the Articles of Incorporation of the charitable corporation within the constraints of § 501(c)(3), this author believes there is evidence that more is expected by the public than simply performing these activities legally, with no attention to the effect on the community.

The Senate Committee on Finance’s attention to charity care, community benefit, and hospital collection practices is one indicia that more may be expected, at least from hospitals. The scope of this Committee’s work is evidence that supports one of the premises of this article. There is a growing legal and public perception that it is legitimate to expect that the charitable corporation provides an added value to the public beyond legal compliance with its legal form. Legal compliance, at its minimal level, is simply acknowledging that the same activities can be performed under two different legal regimes, private business and public charities. The “added value” proposed here—that of the common good, affirmative service to the public, and the contributions to civic society of the charitable independent sector—is illustrative of the content of the duty of obedience. The “added value,” this author suggests, needs to be demonstrable in fact and credible to the public. Only the duty of obedience serves as a catalyst to the question: what is the added value, or the public interest, that the corporation is serving through its activities performed in legal compliance with its legal form?

Certainly, the charitable corporation does not exist simply to give directors the opportunity to be careful with assets and to subordinate their private interests to the interests of the charitable corporation. After all, don’t the for-profit directors have the same duty? The interest of the charitable corporation is to benefit the public through its activities. Some human agent has to identify and monitor that achievement in a specific community. This is the logic of the necessity of the duty of obedience. In the language of the Causes, it is through the consciously “desired effect” of the human agents that effectiveness is imparted to the charitable assets. It is through proper management of the assets that the capability of the charitable corporation is increased. The unity be-

80. INDEPENDENT SECTOR, PRINCIPLES OF GOOD GOVERNANCE, supra note 27, at 3.
81. See Baucus/Grassley Letter, supra note 24.
tween the Primary Efficient Cause (human actors) and the Instrumental Efficient Cause (the assets) is intrinsic to and remains in the charitable corporation. If the human agent has no consciously desired effect to impart to the assets objectives that are "in important respects . . . fundamentally different . . . from profit-making organizations," and if the only applicable duties are those of care and loyalty, the effect of the assets may fall short of being charitable. This is the content of the duty of obedience, often referred to as "mission" or "mission/purpose."

Before getting into a discussion of the proposed distinction between the meaning of mission and purposes as the content matter of the duty of obedience, it will be helpful to consider the nature of the duties of care and loyalty as derivative of the duty of obedience in terms of the Four Causes and the metaphor of the watchmaker. These duties are derivative of the duty of obedience because they are duties that apply to the use of the stuff and the legal form to impart effectiveness to the corporation. But such effectiveness can only arise from the intentionality of the directors, and it is the duty of obedience that requires the directors to establish and pursue the charitable organization's "desired effect"—i.e., creating a benefit to the public.

_Duty of Care: Procedural Protection of Assets_

Fremont-Smith, in discussing the evolution of state-law standards for the duties of care and loyalty, indicates that there is no agreement on the distinction between the components of the duty of care and the duty of loyalty. For example, she notes that the components of the corporate standard of the duty of care in the Revised Model Nonprofit Corporation Act include the duty of acting in good faith. However, "[s]ome sources refer to the duties to act in good faith and in the best interest of the corporation as elements of the duty of loyalty."

In Causal terms, the duty of care addresses the assets that have the potential to be the Material Cause and the Instrumental Efficient Cause of a public benefit charitable corporation if they effect charity or a benefit to the public. This duty, at best, addresses the collection and management of material assets and efficient and

82. _BJORKLUND ET AL., supra_ note 20, § 10-1.
83. _FREMONT-SMITH, supra_ note 4, at 203.
84. _Id._
85. _Id._
prudential use of the assets. The duty of care, standing alone, does not address the mind-set of the directors in regard to the "why" (or the "desired effect) that the use of the corporation's assets (even if carefully managed) has in a specific community. The duty of care, focusing on the internal attentiveness of directors, is not sufficient to help differentiate the value to the community of the delivery of services by the charitable corporation from that of such delivery by a for-profit corporation. Without reference to an articulated duty of obedience (whatever the articulation is), the duty of care leaves a vacuum that assures (1) a lack of accountability to the public for the increasing "convergence between non-profit and for-profit sectors" and (2) the consequent "ambiguity of [the effect of commercial activities] on pursuit of mission."

As long as commercial activities are properly undertaken within current legal standards, the duty of care is not violated. The duty of care does not put the question of the level, if any, of social value of the charitable activities and the relationship of this social value to the distinctive aspects of the charitable corporation, squarely before the board in determining the immediate and long-term impact of a legal, financial, and strategic plan. Nor does the duty of care invite any conversation concerning a potential commercial culture that may exist in the corporation. Such a culture may be the root of the Senate Finance Committee's investigations into tax-exempt hospitals' executive compensation, adequacy of free care, and commercial billing practices as cited earlier. The duty of care, standing apart from a duty of obedience defining the desired effect of a charitable corporation, justifies a bottom line based solely on economics. Economic efficiency (or profit maximization) is an indispensable instrumental value in the charitable corporation. Such efficiency is instrumental; it should not be equated with the ultimate "desired effect" of the public charitable corporation. For this reason, this author suggests that the duty of obedience cannot be subsumed into the duty of care. Without the "consciously desired effect"—the content of the duty of obedience—the financial and business plans of the charitable corporation may

86. See generally UNIF. PRUDENT INVESTOR ACT (1994).
87. FREMONT-SMITH, supra note 4, at 15 (discussing policy issues facing the nonprofit sector in the Twenty-First Century and citing BURTON A. WEISBROD, THE VOLUNTARY NONPROFIT SECTOR: AN ECONOMIC ANALYSIS (Lexington Books 1977)).
88. Id. at 16 (citations omitted).
89. For example, a corporation may have an insubstantial amount of unrelated business income without losing its exemption. See I.R.C. §§ 511, 512 (2000).
actually be disconnected from the *raison d’être* of the corporation, though not necessarily from the formal legal duty of care.

The duty of care, standing alone, is procedural. Without the articulated duty of obedience, the duty of care functions to describe *how* to protect a heap of things without addressing the “why”—that is, the defined destiny for the use of the assets. The duty of care has the potential to be differentiating in practice only in relationship to the “desired effect” of the human agents who deploy the assets. Therefore, in a charitable corporation, where by definition the acquisition and maximization of profit is not the End or ultimate Purpose of the corporation, the duty of care is a derivative duty of the duty of obedience.

*Duty of Loyalty: Protects the Public Benefit as the Target Audience but not the “Desired Effect”*

The duty of loyalty is defined as fair dealing, or the subordination of the individual and private interests of directors to the interests of the corporation whenever there is a conflict. In the Cause paradigm, this duty protects the organizational “form” of the corporation—specifically, the dedication of the assets to the use of the target group, the public—from being derailed for the private benefit of a director. The articulation of the duty recognizes that human beings by nature “direct their human acts to a Final Cause of private good.” The duty of loyalty is actually a negative duty. It says what directors can’t do, not what they should do. Without a defined “desired effect” concretizing the meaning of what added benefit the public actually gets from activities deemed charitable, there is a vacuum. While the authorized activities are social goods deemed so by the legislator, they do not in themselves describe the intended social effect of implementation of the activities in the community. The public benefit as the organizational form only describes the target of the social good as the broadly based “public,” and not a private individual or good. The interesting fact is that there is no current law requiring that the needy have access to the social goods provided by exempt corporations or even the equitable distribution of its resources, whether they be dedicated to health, education, social welfare, or cultural goods. Thus the duty of loyalty, standing alone, gives no

90. FREMONT-SMITH, supra note 4, at 215; KURTZ, supra note 18, at 59-60.
91. Henle, supra note 33, at 42.
guidance to the fair and equitable effectiveness to be imparted to the assets for the common good.

While it is true that there has been private wrongdoing in the nonprofit sector and that the duties of care and loyalty have been breached, this author suggests that the breach of these duties, short of willful misconduct, is related to the absence of a consciously articulated, affirmative duty of obedience. The duty of obedience creates the frame of reference of the duties of care and loyalty because it, uniquely and fundamentally, forces an articulation by the first line of human actors—the board of directors—of the distinctive value resulting from the charitable corporation they govern. The duty of loyalty is the first and foremost duty of self-regulation that is derived from the pre-existing duty of obedience. Kurtz describes this derivative relationship in the following way:

The basic duty of loyalty . . . requires a director to have an undivided allegiance to the organization's mission (see the discussion of the duty of obedience below) when using either the power of his position or information he possesses concerning the organization or its property, and it bars a director from using his position or information concerning the organization and its property in a manner that allows him to secure a pecuniary benefit for himself.  


A. A Word on Language

Three phrases are used in the context of charitable corporations: “purposes,” “mission,” and “public benefit.” “Purposes” means the activities described in the Articles of Incorporation that are within the categories enumerated and described as purposes in § 501(c)(3) of the Internal Revenue Code. Though “mission” appears in many scholarly works, it is not used in the text of §
501(c)(3). This author has not found a generally acceptable definition of "mission" by commentators using the term. "Mission" is sometimes used to denote a more specific statement of the general purposes in the Articles of Incorporation. Others appear to use "mission" at times to imply some indicia beyond just the performance of functions described in the eight categories of 501(c)(3) and the non-distribution constraint, such as serving the poor in underserved areas. "Public benefit" has been used to mean the opposite of private benefit, which is explicitly prohibited in the text of § 501(c)(3) of the Internal Revenue Code.

In this article, the terms will be used with the following meanings. "Purposes" with a capital "P" has two parts: mission and authorized activities. "Mission" means the "desired effect" of the performance of the activities authorized by one of the categories in § 501(c)(3). In this sense, mission is the first component of Final Cause—the intentionality of the human actors (the legislator and the board) for the activities of the corporation. "Purposes" with a lower-case "p" means the activities generally authorized by or specifically identified in the charitable corporation's Articles of Incorporation. The performance of these authorized activities is the second component of the Final Cause. Finally, "public benefit" is used in the following discussion to mean the benefit or added value to the public from the presence of the charitable corporation. This meaning is better expressed, however, by "benefit to the public." In this sense, "public benefit" or "benefit to the public" is used in the context of the mission definition to mean the "desired effect" imparted by the human agents to the performance of authorized activities in the Articles of Incorporation.

B. "Mission" Defines the Distinct Benefit of a Specific Corporation.

The distinction between mission and purposes as proposed in this article follows the two components of the Final Cause as used to explain the duty of obedience in the preceding discussion. "Mis-

95. ABA GUIDEBUOOk, supra note 94, at 7.
96. See MEETH, 715 N.Y.S.2d 575, 584 (N.Y. Sup. Ct. 1999) (quoting the minutes of the MEETH board).
97. See I.R.C. § 501(c)(3). The legal requirements are organized and operated for one of the authorized categories in § 501(c)(3)—the prohibition of private benefit, limitations on lobbying, and prohibition of political activity. Id.
sion" is the desired effectiveness of the corporation in the local community, which the board publicly states is to be imparted through the authorized activities of the charitable corporation. Therefore, once exempt status is granted to a corporation, the scope of its activities is objectively determined by the category of § 501(c)(3) under which it qualifies as an exempt corporation. “Mission,” as used here, is a more subjective determination because it is determined by the board of directors and changes with the board’s shifting understandings of charity and public benefit in a given environment. 98 However, though subjective in regard to the desired effectiveness of a charitable corporation in a given community at a given time, the mission, as defined herein, requires a concrete statement subject to objective evaluation. For example, a charitable corporation’s mission may be to serve the needs of specific underserved populations, to address identifiable needs in a community, or even to provide more equitable access among all members of a community to the organization’s services, whether they be health, education, or cultural goods. The mission is subjective in the sense that a board of directors names the specific mission of a specific corporation in a specific community. However, to be useful, the mission must be stated in concrete terms, subject to identifiable benchmarks for measuring the effectiveness of the activities in meeting the stated mission—which is more than simply the performance of activities with no consciousness of the intended value or benefit coming from those activities.

The mission needs to be publicly stated. 99 This public mission statement, ironically, both provides the corporation with the stability to achieve the benefit to the public arising from its 501(c)(3) category and provides the directors with the flexibility needed to alter activities within that category to meet changing notions of charity in changing environments. Such objectively measurable mission statements provide both transparency and accountability regarding the benefit to the community which results from the privileged legal status of charitable assets. When it is shown by objective benchmarks that the mission as stated is no longer needed, or that the corporation does not have the capacity to carry on its activities in a reasonably efficient way to achieve the desired impact on the community, the mission—the effect of the authorized activities—may be at risk. Therefore, fundamental

98. See Blazek, supra note 4, at 26; Fremont-Smith, supra note 4, at 100-01.
99. See, e.g., Independent Sector, Principles of Good Governance, supra note 27, at 12 (suggesting publication of mission statements).
changes such as the monetization of assets, conversions, mergers, or dissolutions, may be justified. "Mission," defined as the measurable effect of the benefit, the added value to a specific community from the performance of any of the activities authorized by and carried on within the parameters of the legal form of the charitable corporation, directs and controls the strategic financial and business plan. Decisions made in obedience to the public statement of mission should be presumed correct as "long as the judgment is plausibly rational, involves no conflicting interest, and the director has acted in a manner that he believes reasonably is informed." 100 Decisions originating in and faithful to a stated "desired effect" and meeting these criteria are most likely to meet any reasonable expectation of transparency and accountability.

The application of objective benchmarks to a public mission statement as defined here offers other strategic policy and operational benefits for the functioning of the charitable sector. In a discussion of the challenges of for-profit organizations entering into the world of welfare to work, William Ryan identifies some of the following policy and operational questions that will need to be addressed by the charitable sector. What is the "very asset that makes the public charitable sector so vital to society in the first place"? 101 Can the management of the charitable corporation adapt to external forces on the corporation without "compromising the qualities that distinguish them from the for-profit organizations"? 102 Does the corporation use different criteria for the bottom line to effect the desired results for the community from the corporation in light of market forces "that reward disciplined performance rather than for-profit or not for-profit status and mission"? 103 Is the mission to the local community at odds with regional and national organizational structures? 104 Ryan suggests that "it seems naive to think that for-profits in search of profitable business opportunities will voluntarily serve the interest of the common good." 105 The common good is the mission that controls the performance of the purposes—i.e., the authorized activities of the corporation—and not simply the minimum requirements of the legal form of the corporation. The definition of mission as the

100. KURTZ, supra note 18, at 49.
102. Id.
103. Id.
104. Id.
105. Id. at 132.
measurable desired effect, one component of the duty of obedience, requires the board of a public charitable corporation to make specific and concrete its contribution to the common good of its community.

4. Medieval Language of “Desired Effect” and Contemporary Analogs

While this explanation of the duty of obedience and its relationship to mission and purposes has relied on medieval concepts, the suggested relationship between mission and purposes may be imposed upon several contemporary sources: the American Bar Association, the Internal Revenue Service, and the MEETH Court. The author admits that the imposition of the medieval analysis of this paper relies more upon reading into the language of these sources than on the language of the texts themselves. However, the following is presented as, at least, a reasonable imposition by analogy.

A. American Bar Association Guidebook for Directors of Nonprofit Corporations (ABA Guidebook)

Though the duty of obedience is not discussed in the ABA Guidebook, the value of the mission statement as a tool to focus the activities of the board of directors is discussed under the heading of “The Corporation’s Purpose and How it Affects a Director,” where it is stated that “[i]n all nonprofit corporations, the corporate purposes should be stated, at least in general terms, in the articles of incorporation . . . . The corporate purposes may also be reflected by a mission statement adopted by the board . . . .106

In this context, the ABA Guidebook appears to use “mission” to also mean corporate purposes. Later, under the heading of “Use of Mission Statements,” the Guidebook continues:

The articles of incorporation and bylaws may define the broad general purposes of the corporation; however, the mission statement should be more specific. As a practical matter, confusion over mission impairs the efficiency of the board in the discharge of its duties. On the other hand, adoption or renewal (such as at an annual board retreat) of a corporate mission statement can rekindle the energies and help focus the

106. ABA GUIDEBOOK, supra note 94, at 6.
attentions of the board members, both individually and collectively . . . .

Mission statements come in varying styles and shapes. An effective mission statement succinctly reflects the board’s agreement regarding the corporation’s purposes and constituencies . . . .107

In this sense, the Guidebook’s function for the mission statement as a tool for the board to focus agreement on its activities and constituencies approximates the function of identifying the “desired effect” of the activities of the corporation, as illustrated by the explanation of the Final Cause. As an example of the focusing value of a mission statement, the Guidebook suggests the mission statement is a guide for planning and strategic decisions.108 It continues, “periodic examination of a mission statement will reveal whether current mission is consistent with the articles and bylaws, and if not, what changes in such documents may be required.”109

The use of “mission” in the ABA Guidebook does encourage, at least indirectly, what this article proposes the duty of obedience does directly. One, the board needs to articulate its constituencies. Two, a clarification of mission that reduces confusion of the board in regard to the reason for its corporate activities may increase its efficiency. Three, a clarification of constituencies may lead to its sequel: what is the corporation doing for its identified constituencies, and why? Finally, the mission statement is a guide for planning and strategic decisions which may require changes to current activities.

B. Internal Revenue Service Good Governance Practices

The recent set of good governance practices for 501(c)(3) organizations circulated by the Internal Revenue Service110 captures the meaning of the “desired effect” and the “focus” of the authorized activities undertaken in a charitable corporation by using another phrase much closer in content to the Final Cause explanation. The IRS statement parallels the two components of the Final Cause—the purpose of the actors and the purposes of the author-

107. Id. at 7.
108. Id.
109. Id. at 8.
110. I.R.S. GOVERNANCE, supra note 37.
ized activities—in the following way: “[a] clearly articulated mission, adopted by an organization’s board of directors, serves to explain and popularize the charity’s purpose and guide its work. It also addresses why the charity exists, what it hopes to accomplish, and what activities it will undertake, where, and for whom.”\textsuperscript{111}

“Why the charity exists” and “what it hopes to accomplish, where, and for whom” are analogous to the “desired effect” of human agents. The range of activities that are undertaken to achieve the hoped-for accomplishments are the authorized purposes in the Articles of Incorporation. All three of these terms—the “desired effect,” the “why,” and the “hoped-for accomplishment”—serve to get at the same issue: what makes the charitable corporation be what it is supposed to be in reality?

\textbf{C. Manhattan Eye, Ear & Throat Hospital v. Spitzer (MEETH)}

It has been argued in this article that the duty of obedience and its content—described as a publicly stated mission statement with objective criteria for the “hoped-for accomplishments” of the corporate purposes—provide flexibility to the board of directors. This author suggests that the court’s reasoning, if not its decision, in \textit{In the Matter of Manhattan Eye, Ear & Throat Hospital v. Spitzer (MEETH)},\textsuperscript{112} though sometimes seen as a strict interpretation of the duty of obedience, can be read in terms of the paradigm of the Final Cause—i.e., the desired effect of the directors and the purpose of the activities of the hospital. From this perspective, the court’s discussion of the weaknesses of the decisional process of the Board of Directors of the Manhattan Eye, Ear & Throat Hospital (the “Hospital) is instructive. This author believes that the relationship between mission and purpose as suggested in this article can also be imposed on the court’s reasoning, even though the court’s conclusion focused on the literal language of the purposes stated in the Hospital’s Articles of Incorporation. For purposes of the duty of obedience as described here, the court’s reasoning concerning the decisional process of the Hospital board is more important and instructive than its decision.

As required by the New York Not-for-Profit Corporation Law,\textsuperscript{113} the Hospital sought the court’s approval of a sale of its hospital

\textsuperscript{111} \textit{Id.}
\textsuperscript{112} 715 N.Y.S.2d 575 (N.Y. Sup. Ct. 1999).
\textsuperscript{113} See \textsc{N.Y. Not-for-Profit Corp. Law} \$ 511 (McKinney 2005).
facility to another hospital, which then would operate a breast
cancer facility. In addition, substantial property was to be sold to
a private real estate developer who intended to construct apart-
ment buildings. The Hospital proposed to use the proceeds to op-
erate diagnostic and treatment centers at various sites throughout
Harlem, Brooklyn, and South Bronx.114

The significance of the MEETH decision is the court's discussion
of the analytical process required by a duty of obedience. The
court described several fundamental weaknesses in the decisional
process of the Hospital board in the development of the plan sub-
tmitted to the court for review. The court could not find in the re-
cord any evidence of the board's desire to meet community need.
The court's requirement of community need as the initiating and
controlling issue of the Hospital's decisional process came from the
Hospital's justification for its proposed plan.115 The court noted
that in the mind-set of the Hospital board, "the real estate was the
only asset of [the Hospital] with value [and] was the real motiva-
tion that determined the future course of action."116 The board
wanted to "monetize the assets," rather than seek to preserve the
Hospital as its main priority.117 Though the Hospital alleged it
was incapable of continuing to operate the Hospital as currently
structured,118 the court noted that there was no study of the need
for the proposed activities to return to the "original mission" and
no written record concerning the board's decision to return to its
original mission to serve the poor and redirect its charitable assets
to accomplish that goal.119

In addition, there was evidence of managerial difficulties with
physicians. The court continued by noting that the strategic plan
neither addressed the lack of "harmony" with physicians "nor dis-
cussed whether solving this lack of harmony could or would have
changed or altered its evaluation and ultimate conclusions."120 In
reviewing the alternatives available to the Hospital to continue
the activities as defined in its Articles of Incorporation, the court
noted that "not all strategic plans were evaluated."121 This read-
ing of the facts led the court to conclude:

114. MEETH, 715 N.Y.S.2d at 576.
115. Id. at 585.
116. Id. at 580.
117. Id. at 579-80.
118. Id. at 594.
119. MEETH, 715 N.Y.S.2d at 584.
120. Id. at 579, 581.
121. Id. at 581.
The decision to "monetize" drove the need to change the corporate purposes, and these new or reprioritized purposes then became the basis for the argument that "purposes of the corporation . . . will be promoted." A careful evaluation of whether there was a basis for changing the corporate purposes would have determined the need to sell, not vice versa. The total absence of any study beforehand, concerning the [Diagnostic and Treatment (D&T)] Centers, and the retention of health care experts, only after submission of the proposal to the DOH, and only to prepare a business plan "for fulfillment" or in "support" of the D&T proposal, not to independently evaluate the plan's feasibility, buttresses the conclusion that the sale drove the change in purpose. . . . To argue that [the Hospital] was returning to its original purposes without an iota of evidence that it made this fundamental determination prior to the decision to sell and close, cannot obscure the fact that this decision, of necessity, eliminated the [Hospital's] historic mission, its historic raison d'etre.\textsuperscript{122}

While the court's analysis of the duty of obedience was in the context of a two-pronged test under New York law,\textsuperscript{123} the court's description of an appropriate analytical approach to the fundamental decision to monetize charitable assets is applicable both to the duty of obedience generally and to the function of mission (for example, community need) in relation to authorized activities ("purposes")—at least as proposed in this article. If the Hospital had started by identifying what the "desired effect" (community need) of its current activities in the community was, and then had shown how it could not have met those needs through a prudential use of assets in a variety of scenarios, objectively analyzed; and if consistently through the process the original mission of "serving the poor in underserved areas and redirecting its charitable assets to accomplish this goal"\textsuperscript{124} had been the question researched by the consultants and the criterion used to design and evaluate proposals, a modification of hospital services to diagnostic and treatment centers may have been supported by the evidence. Such a process may have shown that (1) such services were needed in the underserved area in the city and county of New York, and further that (2) monetization of some assets was a necessary and efficient

\textsuperscript{122} Id. at 596.
\textsuperscript{123} See N.Y. NOT-FOR-PROFIT CORP. LAW § 511 (McKinney 2005).
\textsuperscript{124} MEETH, 715 N.Y.S.2d at 584.
use of charitable assets to meet a demonstrable charitable mission of community need. The court noted there was not an "iota of evidence" that a studied need to reprioritize purposes then led to the need to sell.

While it cannot be argued that *MEETH* distinguishes "mission" and "purposes" as proposed in this article, it is suggested that the court's use of "community need," which it excerpted from the Hospital's claims, is a fair and reasonable analogy to the use of the "desired effect," the "focus," or the "hoped for accomplishment" to guide decisions in regard to reprioritizing, modifying, or terminating a charitable organization's historic activity authorized in the purpose statement of the Articles of Incorporation.

This author's suggestion that *MEETH*, read from the standpoint of the duty of obedience—emphasizing mission as the publicly stated, measurable "desired effect" for purposes in the Articles of Incorporation—may have resulted in a different conclusion of the application of the duty of obedience, is supported by the court's citation to Bjorklund, prefacing its analysis of the proposed Hospital transaction:

"[A] hospital or clinic providing specialized services, that is so deeply in debt that its provision of services is seriously jeopardized, may wish to transfer its assets to another clinic or hospital providing basically the same services in return for assumption of its debt. The only alternative may be the protection of federal bankruptcy laws or a receivership under state law for the benefit of creditors."

While it may be appropriate, in certain cases, to solve financial difficulties by eliminating the organization's mission by selling its assets and then undertaking a new mission, the passage properly focuses attention on the duty of obedience, which mandates that a Board, in the first instance, seek to preserve its original mission. Embarkation upon a course of conduct which turns it away from the charity's central and well-understood mission should be a carefully chosen option of last resort. Otherwise, a Board facing difficult financial straits might find sale of its assets, and "re prioritization" of

125. *Id.* at 596.
126. *Id.*
127. The record in *MEETH* indicated that other duties such as the duty of care and loyalty may have been breached. This commentary is only focusing on the duty of obedience.
its mission, to be an attractive option, rather than taking all reasonable efforts to preserve the mission which has been the object of its stewardship.\textsuperscript{128}

5. Conclusion

The doctrine of the duty of obedience is a logical necessity for fulfilling the fiduciary duties of directors of charitable corporations so that the governance and the benefit to the community is "transparent and accountable."\textsuperscript{129} The definition of the duty of obedience in terms of "mission" and "purposes" as offered here—though in a framework of medieval logic—is consistent with contemporary standards of good governance and the need for flexibility of directors to respond to changing environments. A statement of a duty of obedience, through either the approach presented in this paper or another, is essential to strengthening the long-term viability of the charitable sector. Without it, the blur between the nonprofit and the for-profit sectors will erode the strength and scope of the charitable sector in significant areas such as health, education, and social welfare. In addition, without a requirement of a duty of obedience, activities may continue to be exempt without a measurable added benefit to the public. Mere legal compliance with the duty of care or duty of loyalty, measured by the business standard, offers no public accountability for the added value to the public benefit or for more equitable access to the social, educational, health, intellectual, and cultural resources of public benefit charitable corporations. The expectation and identification of the measurable added value to the public of the activities of the charitable corporation requires the conscious desire and will of human agents.

The duty of obedience is necessary because human agents are the front line in determining the performance of the charitable corporations. Why they act and why the public thinks they should exist, need to be in sync with each other. This can only happen through the duty of obedience because only directors can impart effective "charitableness" to the corporation. If there is no effectiveness to the mission of the public charitable corporation's "matter and form"—its stuff—then meeting the duties of care and loy-

\textsuperscript{128} MEETH, 715 N.Y.S.2d at 595 (quoting BJORKLUND ET AL., supra note 20, § 8-2[b][3]) (alteration in original). Bjorklund does not use the "mission" and "purpose" distinction as presented in this paper.

\textsuperscript{129} See generally INDEPENDENT SECTOR REPORT, supra note 8.
ality has little potential to give legitimacy to the privileges of the charitable sector.

By definition, the duty of obedience does establish parameters for the decisions of the board of directors. The duty of obedience as explained here, however, does not add any inflexibility or narrow the parameters inherent in the legal form of a charitable corporation.

It appears illogical to this author to say that transparency and accountability are the remedies to the charitable sector’s credibility issues identified in the opening paragraphs of this article, and at the same time, to eliminate or bury the unique duty that makes a charity a charity. Further, it seems illogical to compound the problem by arguing for generic and minimal statements of purpose in the public document of accountability, the Articles of Incorporation, and then to gloss this all with the business judgment rule.

The duty of obedience as suggested here gives both accountability and flexibility to a board of directors. The definitions of “mission” and “purpose” and the decisional process identified by the MEETH court give as much predictive guidance to a board of directors as the business judgment rules gives to the classical definitions of the duty of care and duty of loyalty. The retention of a duty of obedience and the application of a prudential judgment rule to a decisional process showing an evaluation of strategies to meet the pre-established and published “desired effect” of the corporation’s activities, create the frame of reference for the duties of care and loyalty. This is an efficient and economical mechanism for public accountability.

A duty of obedience that requires a mission statement telling the public the measurable impact on the community expected from the presence of the charitable corporation, creates an internal corporate culture that gives meaning to the legal form and makes the charitable corporation actually be what it is intended to be—with its profit.