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NOTES

THE HERSHEY TRUST'S QUEST TO DIVERSIFY: REDEFINING THE STATE ATTORNEY GENERAL'S ROLE WHEN CHARITABLE TRUSTS WISH TO DIVERSIFY

INTRODUCTION

In 2002, the trustees of the Hershey Trust, in an effort to diversify the trust's holdings, started down the path to sell the trust's controlling interest in Hershey Foods Corporation. As offers to buy the controlling interest emerged and the sale came close to being consummated, the Pennsylvania Attorney General, in his *parens patriae* role, sought to block the sale by petitioning a court to order the trustees of the Hershey Trust to show cause as to why the sale of the trust's controlling interest in Hershey Foods should not require court approval.¹ The Pennsylvania Orphans' Court granted an injunction halting the sale and the Commonwealth Court of Pennsylvania later affirmed this injunction. Subsequently, the trustees agreed to an out-of-court settlement and voted against selling the Hershey Trust's controlling interest in Hershey Foods.

This Note examines the state attorney general's role in the supervision of a charitable trust. Specifically, in light of the Hershey Trust's settlement with the Pennsylvania Attorney General agreeing not to sell its controlling share in Hershey Foods Corporation, this Note argues that the power of the attorney general should be limited when (1) a trustee has discretionary power to make investments as expressed in the trust document, and

1. For relevant background material on recent developments concerning the Hershey Trust, see generally *In re Milton Hershey Sch. Trust*, 807 A.2d 324 (Pa. Commw. Ct. 2002).

(2) a trustee, in good faith and without breaching any fiduciary duties, uses this discretionary power to diversify the charitable trust's investments.

Part I of this Note examines the legal doctrine of charitable trusts, how they are formed, what their purposes may be, and what fiduciary duties apply to their trustees. Part I also sets forth the framework of a trustee's duty to diversify the charitable trust assets under the Prudent Investor Rule and Pennsylvania's adoption of that rule.² Part II discusses the historical underpinnings of the attorney general's *parens patriae* role in supervising charities as well as the attorney general's current function. Part III of this Note analyzes the actual language of the original trust document to discuss the formation of the Hershey Trust and the powers granted to its trustees. Part III also describes the circumstances surrounding the recent settlement of the Hershey Trust with the Attorney General, and includes a description of Pennsylvania's rather stringent legislative response to the Hershey Trust's actions. Part IV offers recommendations for placing limits on an attorney general's action by outlining the procedure that an attorney general should follow when faced with situations similar to the Hershey Trust's quest to diversify.

I. CHARITABLE TRUSTS

A. Background

Charities, particularly in the form of charitable trusts and charitable foundations, play a significant role in meeting the needs of many Americans. Due to this significance, it is helpful for purposes of this Note to explain how charitable trusts came to be recognized legally in this country.

Charitable trusts formed in the United States today trace their legality back to early English common law. Historically, the laws pertaining to charities, and more specifically, charitable trusts, were embodied in the law of trusts that the English Courts of

2. 20 PA. CONS. STAT. ANN. § 7201, official cmt. (West 1999).

Chancery developed.³ A significant law that the English enacted was the Statute of Charitable Uses of 1601, which sought to establish an efficient enforcement scheme to protect against the mismanagement of charities and their funds and "guid[ed] for centuries the development of the charitable trust."⁴ As people left England for the New World, early colonial settlers continued the English tradition of private charity in the American colonies.⁵

After the Revolutionary War, the framers of the U.S. Constitution did not specifically enumerate charitable institutions as one of the powers of the federal government.⁶ As such, most charities "are chartered under the auspices of a state."⁷ Many states passed laws that supported charities.⁸ For example, a 1776 draft of Pennsylvania's Constitution stated that "all religious societies or bodies of men heretofore united or incorporated for the advancement of ... other pious and charitable purposes, shall be encouraged and protected in the enjoyment of the privileges, immunities and estates which they were accustomed to enjoy ... under the laws and former constitution of this state."⁹ Although many states after the Revolutionary War supported charities through legislation, some states, which specifically repealed all English statutes, no longer supported charities because they wished to rid themselves of any vestiges of English sovereignty.¹⁰

In 1819, the U.S. Supreme Court addressed the legality of charitable trusts in *Trustees of the Philadelphia Baptist Ass'n v.*

3. MARION R. FREMONT-SMITH, *FOUNDATIONS AND GOVERNMENT* 82 (1965).

4. JAMES C. BAUGHMAN, *TRUSTEES, TRUSTEESHIP, AND THE PUBLIC GOOD: ISSUES OF ACCOUNTABILITY FOR HOSPITALS, MUSEUMS, UNIVERSITIES, AND LIBRARIES* 4 (1987) (noting that the Statute of Charitable Uses is also referred to as the Statute of Elizabeth). "The English Tudor rulers, especially Elizabeth I, hated and feared poverty and vagabondage because they unsettled the whole society." *Id.* See also EDITH L. FISCH ET AL., *CHARITIES AND CHARITABLE FOUNDATIONS* 17 (1974) (discussing the passage of the Statute of Charitable Uses).

5. FISCH ET AL., *supra* note 4, at 20; see also FREMONT-SMITH, *supra* note 3, at 36 (discussing how charitable trusts flourished in Colonial America due to English law's encouragement of philanthropy, churches' teaching of charity, and colonists' needs).

6. BAUGHMAN, *supra* note 4, at 5.

7. *Id.* (noting, however, that the U.S. government has established the American Red Cross).

8. See FISCH ET AL., *supra* note 4, at 20; FREMONT-SMITH, *supra* note 3, at 36.

9. FISCH ET AL., *supra* note 4, at 21 (quoting PA. CONST. OF 1776 § 45).

10. *Id.*; see also FREMONT-SMITH, *supra* note 3, at 37 (citing Virginia as an example).

Hart's Executors.¹¹ In *Hart's Executors*, a case involving a charitable trust in Virginia, the Court ruled that the legality of charitable trusts originated from the Statute of Charitable Uses of 1601 and, because Virginia repealed all English statutes, the particular charitable trust at issue failed legally.¹²

In *Vidal v. Girard's Executors*, decided in 1844, the Supreme Court reversed itself and held that courts should recognize charitable trusts in America despite state statutes that abolished English law.¹³ In deciding *Vidal*, the Court recognized that it erroneously had concluded in *Hart's Executors* that trusts without specific beneficiaries did not exist under English common law before the time of the Statute of Charitable Uses of 1601.¹⁴

Charitable trusts and charitable foundations became an important part of American history and the American social landscape.¹⁵ Throughout the history of the United States, many noteworthy industrialists and business leaders who amassed enormous fortunes established charitable trusts and foundations to bestow some of their wealth on those less fortunate. In the first half of the twentieth century, several notable charitable trusts and foundations originated, carrying the names with the likes of "Russell Sage, Phelps-Stokes, Rosenwald, Duke, Guggenheim, Kellogg, Mellon," Ford,¹⁶ and Hershey. In recent times, Bill Gates, founder of Microsoft Corporation, has taken up the torch of his predecessors

11. 17 U.S. (4 Wheat.) 1 (1819).

12. *Id.* In *Hart's Executors*, Chief Justice Marshall opined that charitable trusts derived their legality from the Statute of Charitable Uses, not from any preceding English common law. See EUGENE F. SCOLES ET AL., PROBLEMS AND MATERIALS ON DECEDENTS' ESTATES AND TRUSTS 710 (rev. ed. 2000).

13. 43 U.S. (2 How.) 127 (1844). In deciding *Vidal*, the Court concluded that charitable trusts did not derive their legality from the Statute of Charitable Uses, but instead were part of English common law. See SCOLES ET AL., *supra* note 12, at 710.

14. FREMONT-SMITH, *supra* note 3, at 37-38.

15. See generally Thomas Parrish, *The Foundation: "A Special American Institution,"* in THE FUTURE OF FOUNDATIONS 7 (Fritz F. Heimann ed., 1973). Other particular appeals of charities are their ability to experiment and incubate innovation: "The American public accepts [independent nonprofit organizations] perhaps based on the assumption that the independent nonprofit sector not only alleviates some of the burdens of government but also is free to experiment with new and creative ideas and programs that would not be as easy, or even possible, otherwise." BAUGHMAN, *supra* note 4, at 3.

16. Parrish, *supra* note 15, at 15-16.

by using his vast wealth for charitable purposes with the formation of the Bill and Melinda Gates Foundation.¹⁷

One of the most influential persons in the history of American charities was Andrew Carnegie, who, in 1889, set forth his “gospel of wealth.”¹⁸ Carnegie defined a millionaire as a “trustee for the poor, [entrusted] for a season with a great part of the increased wealth of the community, but administering it for the community far better than it could or would have done for itself.”¹⁹ The driving idea behind Carnegie’s vision was giving people the means to “realize their potential.”²⁰

Charities play a meaningful part in American society, notably in the form of “orchestras, professional associations, civic groups, social-service organizations, and religious groups ... [as well as] ... museums, colleges and universities, hospitals, and libraries.”²¹

B. Legal Doctrine

Although now vested with an understanding of the legal roots of charitable trusts in the United States as well as the vision behind their establishment, it is also important for purposes of this Note’s analysis to present a brief discussion of the legal doctrine behind charitable trusts. This section discusses how and for what purposes one forms a charitable trust.

The Second Restatement of Trusts defines a charitable trust as “a fiduciary relationship with respect to property arising as a result

17. See <http://www.gatesfoundation.org> (last visited Jan. 28, 2004).

18. Parrish, *supra* note 15, at 14 (noting also that Carnegie had once said that “it is disgraceful to die a rich man”).

19. *Id.* (noting that Carnegie believed that communities should have “universities, libraries, hospitals, medical schools, parks, swimming [pools]”).

20. *Id.* at 15. James Baughman has aptly described “America’s charitable enterprise” by quoting the words of John D. Rockefeller, III:

Government alone cannot solve our massive and complex problems. We need the input of the private sector—the input of individual initiative which has been the great strength of this country from the beginning. We are a pluralistic society. Philanthropy is a means, not an end in itself. It provides funds to make individual initiative effective, in other words to make the private nonprofit sector an effective supplement to governmental effort.

BAUGHMAN, *supra* note 4, at 1 (quoting JOHN D. ROCKEFELLER, III, *THE NONPROFIT ORGANIZATION HANDBOOK* (1980)).

21. BAUGHMAN, *supra* note 4, at 1.

of a manifestation of an intention to create it, and subjecting the person by whom the property is held to equitable duties to deal with the property for a charitable purpose."²² Usually, a charitable trust arises by an inter vivos or testamentary transfer of property.²³ Necessarily, a charitable trust must have a settlor who intended to create such a trust, delivery of property that will be the trust's subject matter, a charitable purpose, and indefinite beneficiaries.²⁴ A charitable trust is not valid until the settlor surrenders legal title to the property creating the trust.²⁵ Unless otherwise provided in the document creating the trust, a charitable trust may continue indefinitely.²⁶

According to the Second Restatement's definition, a charitable trust must be formed for a charitable purpose.²⁷ Such permissible purposes include: relieving poverty, advancing education, advancing religion, promoting health, advancing a government or municipal aim, and any other purposes that benefit a community.²⁸ A purpose of a charitable trust, however, cannot contravene public policy or effectuate committing a crime or tort.²⁹

C. Charitable Trusts Under Pennsylvania Law

Pennsylvania has enacted laws defining charitable trusts that are similar to those embodied in the Restatements. Like other jurisdictions, Pennsylvania requires that the beneficiaries of a charitable trust be indefinite in nature; that is, "[t]he beneficiary of

22. RESTATEMENT (SECOND) OF TRUSTS § 348 (1959).

23. FISCH ET AL., *supra* note 4, at 173-74 (indicating, however, that a charitable trust may also arise by constructive trust); *see also* RESTATEMENT (SECOND) OF TRUSTS § 349 (1959) (listing the ways in which a charitable trust may be created).

24. FISCH ET AL., *supra* note 4, at 174.

25. *Id.* at 179.

26. RESTATEMENT (SECOND) OF TRUSTS § 365 (1959).

27. *See id.* § 348.

28. RESTATEMENT (THIRD) OF TRUSTS § 28 (Tentative Draft No. 3, 2001). A purpose is charitable if it is of "such social interest or benefit to the community as to justify permitting the property to be devoted to the purpose in perpetuity and to justify the various other special privileges that are typically allowed to charitable trusts." *Id.* § 28 cmt. a.

29. FISCH ET AL., *supra* note 4, at 240.

charitable trusts is the general public to whom the social and economic advantages of the trusts accrue."³⁰

Pennsylvania courts have the authority to provide relief if a trustee or representative acts beyond the scope of the trust. In Pennsylvania, a "court ... may restrain a personal representative from making any sale under an authority *not given by the governing instrument* or from carrying out any contract of sale made by him under an authority not so given."³¹ To summarize, "[e]xcept as otherwise provided by the trust instrument, the trustee, for any purpose of administration or distribution, may sell, at public or private sale, any real or personal property of the trust."³² A trustee, however, may not be held liable for a breach of his duty unless that breach caused a loss.³³

D. The Trustee's Fiduciary Duties

A trustee's duties arise from two different origins: the terms stated in the trust document and legally established fiduciary duties.³⁴ Most notably, trustees have fiduciary duties of obedience, care, and loyalty.³⁵ Although the duty to diversify is a subsection of the duty of care, this Note will examine that fiduciary duty separately.³⁶

30. *Estate of Pruner*, 136 A.2d 107, 109 (Pa. 1957); *see also* SCOTT ON TRUSTS § 391 (2001) (stating that in the case of charitable trusts, the beneficial interest is not given to an individual but rather to the public).

31. 20 PA. CONS. STAT. ANN. § 3355 (West 2002) (emphasis added).

32. *Id.* § 7141.

33. *In re McCune*, 705 A.2d 861, 865 (Pa. Super. Ct. 1997) (noting that a party bringing an action against a trustee "cannot be legitimately aggrieved, unless that party has suffered a loss").

34. FREMONT-SMITH, *supra* note 3, at 91.

35. Rob Atkinson, *Unsettled Standing: Who (Else) Should Enforce the Duties of Charitable Fiduciaries?*, 23 J. CORP. L. 655, 661 (1998) (noting the "Trinity" of fiduciary duties trustees must consider).

36. *See* discussion *infra* Part I.D.4.

1. *Duty of Obedience*

In accordance with the duty of obedience, trustees have the duty to preserve the purpose of a charitable trust.³⁷ The trustees are limited in their actions by both the law pertaining to charities and the "specific purpose provisions in the charity's organizational documents or the terms of the particular gifts."³⁸ With regard to breaching the duty of obedience, "[a]ny attempt to take action contrary to the settlors' directions may be deemed to constitute a unilateral and invalid deviation from the trust terms even though the trustee is otherwise given broad discretions in administering the trust."³⁹ A trustee, consequently, must pay close attention to a settlor's instructions before deciding upon a course of action.

2. *Duty of Loyalty*

The duty of loyalty prohibits trustees of a charitable trust from profiting personally at the expense of the charity they apparently serve.⁴⁰ Trustees may not allow the property of the charitable trust to be used for purposes that are noncharitable.⁴¹ Furthermore, trustees may not employ methods of "favoritism" or direct their actions to benefit third parties or other interests.⁴² To adhere to the duty of loyalty, a trustee should not put himself into "a position that would make it difficult for him to be honest and faithful to his duties, or where his self interest would be antagonistic to the interests of the organization to which he owes duties."⁴³

Most famously, Judge Cardozo described a trustee's duty of loyalty in these terms: "A trustee is held to something stricter than

37. Atkinson, *supra* note 35, at 661.

38. *Id.*

39. GEORGE BOGERT, *THE LAW OF TRUSTS AND TRUSTEES* § 541, at 161-62 (rev. 2d ed. 1993).

40. Atkinson, *supra* note 35, at 661.

41. FISCH ET AL., *supra* note 4, at 391.

42. *Id.* at 392.

43. *Id.* (citation omitted); *see also* FREMONT-SMITH, *supra* note 3, at 94 (noting that "[a] trustee's interest must always yield to that of the beneficiary").

the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior."⁴⁴

3. *Duty of Care*

Regarding the duty of care, the trustees have the duty to manage properly the assets of a charitable trust.⁴⁵ Moreover, if the trustee has a specialized skill, he must use that skill.⁴⁶ If the trustee acts diligently and with good faith, then the trustee will not be held personally liable for a bad decision.⁴⁷ Accordingly, the duty of care protects against a trustee wasting or misapplying the trust assets.

4. *Duty To Diversify*

The key fiduciary duty for purposes of this Note's analysis is the duty to diversify. The duty to diversify actually falls under the larger umbrella of the duty of care, which commands a trustee of a charitable trust to manage properly the trust assets.⁴⁸ In order to manage its assets properly, a trustee must preserve the value of those assets.⁴⁹ This duty to preserve value may be accomplished through diversifying the trust's asset portfolio according to modern financial techniques. Stated simply, a trustee's duty to diversify is prescribed by common sense—it is "not prudent to keep too many eggs in one basket."⁵⁰

The Third Restatement of Trusts articulates the Prudent Investor Rule, the standard by which trustees are judged with respect to their investment and diversification decisions.⁵¹ The Prudent Investor Rule both extends and clarifies the older and outdated Prudent Man Rule,⁵² the latter requiring a trustee to act

44. *Meinhard v. Salmon*, 164 N.E. 545, 547 (N.Y. 1928).

45. *Atkinson*, *supra* note 35, at 661.

46. *FREMONT-SMITH*, *supra* note 3, at 98.

47. *FISCH ET AL.*, *supra* note 4, at 396.

48. *See supra* note 45 and accompanying text.

49. *Estate of Pew*, 655 A.2d 521, 542 (Pa. Super. Ct. 1994).

50. *FREMONT-SMITH*, *supra* note 3, at 100 (indicating that whether to diversify is especially pertinent to charitable trusts that received a significant portion of stock from the same corporation).

51. RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE § 227 (1992).

52. *Id.* § 227 cmt. a.

in a prudent and cautious fashion with the overriding purpose to preserve the trust's principal.⁵³ In particular, the Prudent Investor Rule sets forth that the "trustee is under a duty to the beneficiaries to invest and manage the funds of the trust as a prudent investor would, in light of the purposes, terms, distribution requirements, and other circumstances of the trust."⁵⁴ According to the Prudent Investor Rule, this duty to diversify should be "applied to investments not in isolation but in the context of the trust portfolio."⁵⁵ Furthermore, in investment decisions, the trustee has a duty to diversify the trust's investments, except in certain limited circumstances when it would not be prudent to do so.⁵⁶ Most importantly for purposes of this Note, whether a trustee is in breach with respect to this duty depends on the "prudence of the trustee's conduct, *not on the eventual results* of the investment decisions."⁵⁷ Accordingly, process—not outcome—should dictate any liability for a breach of duty to diversify. Taking this principle one step further, examination of the process—not outcome—should guide any authority's action to halt the attempt of a trustee to abide by the duty to diversify.⁵⁸

A particular question regarding whether to diversify arises with a trust's original investments, which are also known as "inception assets."⁵⁹ Whether a trustee should retain or sell the trust's original investments—that is, investments given to the trust at its formation—may properly depend on the "property's special relationship to some objective of the settlor that may be inferred from the circum-

53. RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 481 (5th ed. 1998) (indicating that the assumption behind the Prudent Man Rule is that "trust beneficiaries are highly risk averse and therefore prefer to receive a lower expected return in exchange for taking fewer risks"). A settlor, however, who wants the trustees to make risky investments, may provide for this desire in the trust instrument through the use of express language evidencing that desire. *Id.* at 482. One main difference between the Prudent Man Rule and the Prudent Investor Rule is that the Prudent Man Rule requires the trustees to examine each individual investment and applies that standard to each investment, not the portfolio as a whole as does the Prudent Investor Rule. *See id.*; RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE § 227 (1992).

54. RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE § 227 (1992).

55. *Id.*

56. *Id.*

57. *Id.* § 227 cmt. b (emphasis added).

58. *See discussion infra* Part IV.C.

59. RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE § 229 cmt. a (1992).

stances.”⁶⁰ This special relationship does not need to be stated expressly in the trust instrument.⁶¹ The commentators to the Third Restatement’s Prudent Investor Rule indicated that shares representing control or influence in a publicly held or closely held corporation are examples of such special property.⁶² An example in the Third Restatement, however, describes a situation where the settlor granted to the trust a considerable portion of shares in a single company and, absent any evidence that the settlor wanted the trustees to keep these shares, the trustees are under a duty to diversify such investments by selling a sizeable portion of those shares.⁶³ Absent such special purpose for retaining the property or any other evidence requiring such retention, the trustee thus should be free to abide by his duty to diversify.

In Pennsylvania, the Prudent Investor Rule has been adopted.⁶⁴ Shortly after the Hershey Trust settlement the Pennsylvania legislature amended this rule.⁶⁵ This section, however, will examine Pennsylvania’s Prudent Investor Rule in its pre-amendment state. Under Pennsylvania law, the duty to reasonably diversify does not apply to trusts that already had existed at the time the legislature had adopted the Prudent Investor Rule.⁶⁶ Particularly, before adopting this rule, Pennsylvania had never required trustees to diversify the trust assets and if this rule were made retroactive, then “drafters of old trusts [would have] to have been clairvoyant to have negated a non-existent duty to diversify.”⁶⁷ Because Milton Hershey formed the Hershey Trust before Pennsylvania adopted the Prudent Investor Rule,⁶⁸ the trustees of the Hershey Trust are under no strict duty to diversify. Nevertheless, the trustees of the

60. *Id.*

61. *Id.*

62. *Id.*

63. *Id.* § 229 cmt. d, illus. 1.

64. 20 PA. CONS. STAT. ANN. § 7201, official cmt. (West 1999) (indicating, however, that certain sections of the Uniform Prudent Investor Act, notably sections 4 through 7 and 12, were not adopted).

65. See discussion *infra* Part III.C.

66. 20 PA. CONS. STAT. ANN. § 7204, official cmt. (West 1999).

67. *Id.*

68. See *infra* note 122 and accompanying text (noting the date of inception for the Hershey Trust).

Hershey Trust may always use sound business judgment in following the Prudent Investor Rule and decide to diversify.

Under Pennsylvania law, trustees must “exercise reasonable care, skill and caution in making and implementing investment and management decisions.”⁶⁹ Pertinent to this Note, however, once again process factors more importantly than outcome. The Pennsylvania legislature adopted the Prudent Investor Rule “[as] standards of conduct and *not* of outcome or performance.”⁷⁰ Specifically, to determine compliance with those rules, one must look to the facts and circumstances present at the time of the trustee’s decision.⁷¹ A trustee “is not liable to the extent the [trustee] acted in substantial compliance with the[se] rules ... or in reasonable reliance on the terms and provisions of the governing instrument.”⁷²

A trustee, under Pennsylvania law, may retain the assets that the trust received at its inception, despite the fact that these assets may comprise a “disproportionately large share of the portfolio.”⁷³ It is important to point out that this statute *permits*, rather than *mandates*, a trustee to retain the trust’s inception assets. In doing so, a trustee may consider the “asset’s special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries” when making investment decisions.⁷⁴

The IRS has also weighed in on a charitable foundation’s holding of large portions of a corporation’s stock.⁷⁵ Section 4943 of the Internal Revenue Code defines “[e]xcess business holdings” of a foundation as “an interest in the stock of any given corporation that exceeds a specified percentage of the corporation’s outstanding shares.”⁷⁶ A special excise tax is imposed on foundations that hold such an interest in order to “discourage the use of nonprofit foundations as a device for controlling the governance of a for-profit

69. 20 PA. CONS. STAT. ANN. § 7212 (West 1999) (indicating that if a trustee has special investment skills, he or she must use those skills).

70. *Id.* § 7213 (emphasis added).

71. *Id.* (noting that the trustee’s decision should not be considered in hindsight).

72. *Id.*

73. *Id.* § 7205.

74. *Id.* § 7203(c)(6) (amended 2002).

75. See I.R.C. § 4943 (2000), cited in *Oberly v. Kirby*, 592 A.2d 445, 455 (Del. 1991).

76. *Oberly*, 592 A.2d at 455.

corporation.”⁷⁷ The Internal Revenue Code “includes penalties for investments that ‘jeopardize’ an organization’s charitable mission, such as putting too much money into a single stock.”⁷⁸ Consequently, the Internal Revenue Code also frowns upon trustees who put too many eggs in one basket.

Ultimately, a trustee’s duty to diversify is a duty not to be taken lightly. The underlying rationale behind the duty to diversify is preservation of the *value* of the trust assets. Usually, it takes money in order for a charitable trust to achieve its stated purpose. Those charitable trusts with trustees that are adept at preserving (and indeed growing) the assets of the trust will flourish, not fail. It is easy to confuse, however, the principle of preserving trust value with the notion of preserving initial property granted to the trust. This Note argues that these two ideas are distinct and that preserving value, not preserving property, should be a trustee’s utmost concern.

II. *PARENS PATRIAE*: DEFINING THE STATE ATTORNEY GENERAL’S ROLE

A. *Historical Foundation*

Attorneys general have long played an important role in the oversight of charitable trusts. A state attorney general’s authority to enforce charitable trusts originated with English common law.⁷⁹ The enforcement powers of the attorney general precede the enactment of the Statute of Charitable Uses of 1601.⁸⁰ Professor Austin Wakeman Scott, an authority on the law of trusts, explained

77. *Id.* (citing Tax Reform Act of 1969, H.R. REP. NO. 91-413, at 27-31 (1969), reprinted in 1969 U.S.C.A.N. 1645, 1671-75).

78. Shelly Branch et al., *Sweet Deal: Hershey Foods Is Considering a Plan To Put Itself Up for Sale*, WALL ST. J., July 25, 2002, at A1 (indicating that the IRS rarely follows through on such suits).

79. See BAUGHMAN, *supra* note 4, at 26; COMMITTEE ON THE OFFICE OF ATTORNEY GENERAL, THE NAT’L ASS’N OF ATTORNEYS GENERAL, STATE REGULATION OF CHARITABLE TRUSTS AND SOLICITATIONS 3 (1977) [hereinafter STATE REGULATION OF CHARITABLE TRUSTS]. The chancery courts, in the early fifteenth century, used their equitable jurisdiction to enforce charitable uses, which were the precursors of current trusts. The attorney general intermittently brought such actions for enforcement on behalf of the Crown. *Id.*

80. BAUGHMAN, *supra* note 4, at 26.

the historical underpinnings of an attorney general's enforcement power:

In England the records show that even before the enactment of the Statute of Charitable Uses in 1601 suits were brought by the Attorney-General to enforce charitable trusts. The community [had] an interest in the enforcement of such trusts and the Attorney General represent[ed] the community in seeing that the trusts [were] properly performed.⁸¹

Attorneys general in Colonial America wielded broad powers that had their roots in English common law.⁸² The term "*parens patriae*" describes an attorney general's role in the "public supervision of charitable property."⁸³ In England, "[t]he term *parens patriae* ... was used ... to refer to the monarch's duty to protect property devoted to charitable uses, although that duty was executed by the attorney general who represented the Crown."⁸⁴ In the United States, the term "*parens patriae* refers to the people of the state. Following the English tradition, the attorney general represents the interests of the state in enforcing charitable funds."⁸⁵ Generally, *parens patriae* powers of state attorneys general were firmly entrenched by the latter part of the nineteenth century⁸⁶ and may be summarized with the following:

As the common law devolved on the states and federal government, the attorney general came to represent the state and its interests in charities. [The attorney general] holds a prerogative right not only to protect but also to enforce all charities, as well as to represent interests of the community at large. These are the ancient powers of guardianship over persons under disability and of protectorship of the public interest in charities.⁸⁷

81. AUSTIN WAKEMAN SCOTT, *LAW OF TRUSTS* § 391 (1967).

82. *STATE REGULATION OF CHARITABLE TRUSTS*, *supra* note 79, at 3.

83. BAUGHMAN, *supra* note 4, at 27.

84. *Id.*

85. *Id.*

86. *STATE REGULATION OF CHARITABLE TRUSTS*, *supra* note 79, at 3 (citing several state court cases that in particular upheld the attorney general's *parens patriae* powers regarding charities). *Parens patriae* translates into "parent of his country" and refers to "the duty of the sovereign to protect both the public interest and those with disabilities." *BARRON'S LAW DICTIONARY* 360 (4th ed. 1996).

87. BAUGHMAN, *supra* note 4, at 27.

B. Standing To Sue and Enforcement of Charitable Trusts

In order to understand the role of the state attorney general in the enforcement and oversight of charitable trusts, it is useful to discuss the concept of standing and how standing is limited in the realm of charitable trusts. To bring a suit against another party, the complaining party must have standing to sue.⁸⁸ A helpful way to explain the concept of standing in the area of charitable trusts is to compare who may sue charitable trusts with who may sue private trusts. In a private trust with named beneficiaries, those beneficiaries have standing to sue and “can compel the trustee to carry out the terms of the trust and to administer the trust in accordance with fiduciary standards.”⁸⁹

Unlike private trusts, with charitable trusts, no party “whose interest is only that held in common with other members of the public” may bring an action against a charitable trust, unless a statute grants the authority to sue.⁹⁰ A member of the general public, therefore, does not have standing to sue a charitable trust. Because a member of the general public benefits from a charitable trust but cannot bring suit against such a trust, the government allows state attorneys general to supervise charities and to compel their legal responsibilities.⁹¹ Courts view state attorneys general as the proper parties to initiate a suit to enforce fiduciary duties that charities have towards the public.⁹² In being a necessary party as such, “[t]he attorney general must typically be made a party to any

88. The concept of standing derives from the cases and controversy requirement embedded in the U.S. Constitution. See U.S. CONST. art. III, § 2. In the case of *Allen v. Wright*, the Supreme Court articulated the three constitutional elements of standing: (1) the plaintiff must allege a distinct personal injury, either an actual or imminent, non-speculative, injury; (2) a plaintiff can trace the injury to the defendant's actions; and (3) a court's favorable decision could offer redress to the plaintiff. 468 U.S. 737, 751 (1984).

89. SCOLES ET AL., *supra* note 12, at 605.

90. *Wiegand v. Barnes Found.*, 97 A.2d 81, 82 (Pa. 1953); see also BAUGHMAN, *supra* note 4, at 26.

91. Mary Grace Blasko et al., *Standing to Sue in the Charitable Sector*, 28 U.S.F. L. REV. 37, 38 (1993); see also SCOLES ET AL., *supra* note 12, at 740 (“Suit to enforce a charitable trust is brought by or in the name of the attorney general, or, in a few states, by some local official such as the county attorney. This power of the attorney general exists even in the absence of a statute so providing.”).

92. Blasko et al., *supra* note 91, at 38.

action brought by another person or organization to enforce, construe, modify, or determine the validity of a charitable trust."⁹³

An attorney general's *parens patriae* power over charitable trusts is usually denoted as the power of enforcement,⁹⁴ which implies "the duty to oversee the activities of the fiduciary who is charged with management of the funds, as well as the right to bring to the attention of the court any abuses which may need correction."⁹⁵ This duty, however, does not entail a "right to regulate, or a right to direct either the day-to-day affairs of the charity or the action of the court."⁹⁶ In other words, an attorney general does not have the authority to act as co-trustee of a charitable trust.

Attorney general enforcement and oversight of charitable trusts is indeed less than perfect:

Attorney general enforcement is problematic on a practical level for several reasons. Given the current budgetary constraints facing almost all state governments, the effectiveness of attorney general enforcement is likely to be sporadic, at best. Lack of money, coupled with the obligation to discharge the other important duties of the attorney general's office, contributes to inadequate staffing for the purpose of supervising charities. This often results in a necessarily selective prosecution of only the most egregious of abuses.⁹⁷

Consequently, the means to enforce and monitor charitable trusts are often inadequate.⁹⁸

93. SCOLES ET AL., *supra* note 12, at 740.

94. FREMONT-SMITH, *supra* note 3, at 198.

95. *Id.*

96. *Id.*; see also *In re Milton Hershey Sch. Trust*, 807 A.2d 324, 337 (Pa. Commw. Ct. 2002) (Pellegrini, J., dissenting) (observing that an attorney general does not have the power "to essentially act as co-trustee or co-manager").

97. Blasko et al., *supra* note 91, at 38-39 (citation omitted); see also SCOLES ET AL., *supra* note 12, at 741 (arguing that "busy attorneys general and their staffs do not always satisfactorily discharge their general obligations concerning charitable trusts, nor do they always respond to legitimate pleas for action on the part of interested citizens").

98. SCOLES ET AL., *supra* note 12, at 741 (discussing that some states have enacted some form of legislation to try to address and alleviate such shortcomings in the process by which charitable trusts are supervised).

C. Pennsylvania Law Defining the Attorney General's Authority

The state of Pennsylvania follows similar procedures to those discussed in the preceding section of this Note. In Pennsylvania, charitable trusts are "initially and continuously subject to the *parens patriae* power of the Commonwealth and the supervisory jurisdiction of its courts."⁹⁹ Because the public is the real beneficiary of a charitable trust, the attorney general must be made a party in a proceeding affecting a charitable trust in order to represent properly the public's interest.¹⁰⁰ According to the rules of the Pennsylvania Orphans' Court, the attorney general must be given notice of any pending proceeding.¹⁰¹ Furthermore, an attorney general has the authority "to inquire into the status, activities and functioning of public charities."¹⁰² In this regard, the Pennsylvania Attorney General has standing to bring suit against the trustees of a charitable trust.

D. Acting Beyond Parens Patriae: Pushing a Political Agenda

Attorneys general, however, must factor in scarce resources and budget constraints in deciding how many cases they will pursue against abuses in charitable trusts and, therefore, will select only certain cases to prosecute.¹⁰³ Because they must factor available resources in deciding whether to challenge an action of a charitable

99. *In re Estate of Coleman*, 317 A.2d 631, 634 (Pa. 1974). The attorney general has been called "an integral arm of the sovereign." *Cain Estate*, 16 Pa. D. & C.3d 50, 57 (C.P. Ct. Delaware County 1980). Furthermore, *parens patriae* powers "permitted the sovereign, wherever necessary, to see to the proper establishment of charities through his officer, the attorney general, and to exercise supervisory jurisdiction over all charitable trusts." *Id.* at 59 (citing 3 WILLIAM BLACKSTONE, COMMENTARIES *427).

100. *Estate of Pruner*, 136 A.2d 107, 110 (Pa. 1957) (indicating that the proceeding may be one of "invalidation, administration, termination or enforcement"). A member of the public that a charitable trust benefits is barred from enforcing a duty of that trust because this rule protects the trustees from widespread suits predicated on little investigation. *Valley Forge Historical Soc'y v. Washington Mem'l Chapel*, 426 A.2d 1123, 1128 (Pa. 1981).

101. PA. ORPHANS' CT. R. 5.5 (West 2002) (noting that "no notice to the Attorney General or his designated deputy shall be required with respect to a pecuniary legacy to a charity in the amount of \$25,000 or less which has been or will be paid in full").

102. *Commonwealth v. Barnes Found.*, 159 A.2d 500, 505 (Pa. 1960) (affirming the common law principle that the attorney general is a necessary party in litigation involving charitable trusts).

103. See *supra* note 97 and accompanying text.

trust, attorneys general may consider which cases could advance their careers. The political leanings and ambitions of an attorney general, therefore, may factor into deciding which cases he plans to pursue and which cases he permits to slip through unchallenged.

Several examples of pushing such political agendas have been publicized. One notable example centers on the so-called right to die in the case of *Cruzan v. Director, Missouri Department of Health*.¹⁰⁴ Mark Tushnet argued that in *Cruzan*, the Missouri Attorney General wished to advance his own political agenda by sacrificing the patient's interests when he took the position that "human life is always sacred" to win the favor of the state's pro-life constituents.¹⁰⁵ One thing, in particular, pointed to the fact that the Missouri Attorney General used this case to obtain political favor—"after winning the *Cruzan* case, the attorney general withdrew from later trial court proceedings. Missouri thereby enable[d] Cruzan's family to disconnect her from the machines that were prolonging her existence."¹⁰⁶

Abortion, like the right to die in the previous example, is another hotly contested issue that many voters recognize and deem important. A South Carolina attorney general was also accused of pushing his own anti-abortion political agenda instead of fighting for the protections of women's health when he called for enforcement of more stringent regulations even though physicians in South Carolina fought for an injunction blocking those regulations from becoming effective.¹⁰⁷

Finally, possible layoffs and plant closings always catch the attention of voters, especially if they or their loved ones may be affected. At the time of the Hershey Trust ordeal,¹⁰⁸ the Pennsylvania Attorney General was running for Governor of Pennsylvania as

104. See generally 497 U.S. 261 (1990).

105. Mark Tushnet, *A Goldilocks Account of Judicial Review?*, 37 U.S.F. L. REV. 63, 70 (2002) (quoting CHRISTOPHER L. EISGRUBER, *CONSTITUTIONAL SELF-GOVERNMENT* 59 (2001)).

106. *Id.* (questioning if "Missouri really cared about Nancy Cruzan's life, why would its attorney general permit her medical treatment to end after her legal battle left the public limelight?").

107. Mande Silverman, *RU-486: A Dramatic New Choice or Forum for Continued Abortion Controversy?*, 57 N.Y.U. ANN. SURVEY OF AM. L. 247, 281-82 (2000).

108. See discussion *infra* Part III.

the Republican nominee.¹⁰⁹ In a campaign advertisement, the attorney general “claim[ed] [that] he saved 6,000 midstate jobs by stopping the sale of Hershey Foods Corp.”¹¹⁰ It is not too much of a stretch to infer that the Pennsylvania Attorney General selected to pursue the Hershey Trust situation at least in part to gain some political capital with the Pennsylvania voters.

Ironically, a member of the Pennsylvania Attorney General’s office had approached the Hershey Trust to stress the importance of diversifying its assets.¹¹¹ Even when a member of the trust asked the person from the Attorney General’s office about the effect of a sale on the Hershey community, the staffer allegedly replied that the Hershey Trust had a fiduciary duty to the Milton S. Hershey School and that the community could not be its “sole concern.”¹¹² Understandably, one Hershey Trust insider went so far as to accuse the attorney general of “start[ing] the fire so he could be the one to put it out” and using the case as a political platform.¹¹³

E. Arguments Against Limiting the Attorney General’s Role

Several arguments against limiting the role of the state attorney general with regards to enforcement of charitable trusts may be asserted. One argument is that the government would act ineffectively if it permitted entities to call themselves charitable trusts without commanding them to yield to any inspection or supervision.¹¹⁴ Put more concretely, “[f]oundations should not only operate in a goldfish bowl, they should operate with glass pockets.”¹¹⁵

109. See Peter L. DeCoursey, *Fisher Ad Seizes on Hershey Sale Halt; GOP Hopeful Claims He Saved 6,000 Jobs*, HARRISBURG PATRIOT NEWS, Sept. 26, 2002, at B1 (Mike Fisher, the Pennsylvania Attorney General, subsequently lost the gubernatorial election).

110. *Id.* (indicating, however, that the advertisement conveniently left out the fact that the Attorney General’s staff had previously recommended to the Hershey Trust the need to diversify its holdings).

111. Sarah Ellison, *Sale of Hershey Foods Runs Into Opposition*, WALL ST. J., Aug. 26, 2002, at A3 (discussing a December 2001 meeting between an attorney general staffer and the Hershey Trust board where the attorney general staffer suggested diversification of assets or even an outright sale of the trust’s Hershey Foods stockholdings).

112. *Id.*

113. *Id.*

114. *Commonwealth v. Barnes Found.*, 159 A.2d 500, 505 (Pa. 1960).

115. *Id.* at 505 (quoting H.R. REP. NO. 2514, 82d Cong.).

Another argument regards the aspect of indefinite beneficiaries in a charitable trust as contrasted to definite shareholders in a for-profit corporation.¹¹⁶ Unlike a charitable trust, the corporate form lessens agency costs because corporations have definite owners and definite objectives to make profits.¹¹⁷ Charitable trusts lack definite ownership, so beneficiaries are often unable or disinclined to monitor the actions of the trustees.¹¹⁸ The attorney general, therefore, necessarily monitors charitable trusts to ensure actions of the trustees are in line with the trust's goals.¹¹⁹

This Note, however, does not argue for removing the state attorney general from his role in overseeing and enforcing charitable trusts. Indeed, due to the indefinite nature of charitable trusts' beneficiaries and the substantial legal costs that could be foisted onto charitable trusts if such beneficiaries were permitted to sue, this Note argues that the attorney general should remain a necessary party to any suits brought against charitable trusts. This Note argues instead that an attorney general should refrain from bringing *unnecessary* suits against trustees of charitable trusts, especially in efforts to diversify.

III. THE HERSHEY TRUST

A. *Formation of the Hershey Trust*

For nearly a century, the Hershey Trust has touched the lives of many residents of Hershey, Pennsylvania, and the surrounding communities. By deed of trust, Milton S. Hershey and his wife Catherine endowed an institution known as the Milton Hershey School to benefit orphan children.¹²⁰ The deed of trust instructed that the Milton Hershey School be located in Derry Township, Pennsylvania, and gave preference to children residing in certain Pennsylvania counties.¹²¹ Specifically, the deed detailed "the

116. See generally Geoffrey A. Manne, *Agency Costs and the Oversight of Charitable Organizations*, 1999 WIS. L. REV. 227.

117. *Id.* at 227.

118. *Id.* at 227-28.

119. See *id.* at 228-29.

120. *In re Milton Hershey Sch. Trust*, 807 A.2d 324, 328 (Pa. Commw. Ct. 2002).

121. *Id.* at 328-29 (noting also that Milton Hershey established a community known as Hershey near his chocolate factory that included "banks, a department store, community

purpose of creating and endowing in perpetuity a Foundation for educational purposes to be known as "The M.S. Hershey Foundation."¹²² Mr. Hershey transferred "five thousand (5000) shares of the common stock of the Hershey Chocolate Corporation" at the time of the deed.¹²³ Presently, the Hershey Trust assets contain shares that amount to a controlling interest in the Hershey Foods Corporation.¹²⁴

The deed of trust grants the trustees discretion in making investment decisions by stating:

The funds of the principle of the trust estate and the unexpended income of the property held in trust not immediately needed for the purposes of the trust shall be invested and the trustee at all times by and with the authority and approval of the Managers shall have full power and authority to invest all or any part thereof in any securities which the Trustee and the Managers together may consider safe, whether the said securities or any of them are legal investments for trust funds or not, and neither the Trustee nor the Managers shall be held accountable, for the exercise of its and their discretion, exercised in good faith, as to the character of the investments which may be made by the authority and approval of both.¹²⁵

The deed further grants the trustees the power to sell its investments by stating: "The Trustee shall have power to sell any securities at any time held by it, but no sale of securities nor investments of any kind shall at any time be made by the Trustee, without the authority and approval of the Managers."¹²⁶ The deed, therefore, does not expressly mandate that the trustees or managers of the M.S. Hershey Foundation must keep the shares of

center, hotel, sports facilities, theatre, hospital, utility companies, transportation, and homes for himself and for many of his employees").

122. Hershey Foundation Deed (Dec. 5, 1935) (on file with author).

123. *Id.*

124. *In re Milton Hershey Sch. Trust*, 807 A.2d at 329. On a quick side note, Hershey Foods Corporation manufactures Hershey's, Reese's, and Jolly Rancher candies. See *Profile of Hershey Foods Corporation*, at www.hersheys.com/about/profile.shtml (last visited Jan. 28, 2004).

125. Hershey Foundation Deed (Dec. 5, 1935).

126. *Id.*

Hershey Foods.¹²⁷ Rather, the deed of trust grants the trustees the powers to make investments and dispose of such investments through a sale.

B. Recent Developments: The Hershey Trust's Quest To Diversify

In 2002, the Pennsylvania Attorney General petitioned the court to have the Hershey Trust show cause as to why the sale of its controlling interest in Hershey Foods should not require court approval.¹²⁸ The Hershey Trust maintained that its aim in selling the controlling share of Hershey Foods was to "diversify its portfolio of assets in the School Trust."¹²⁹ The Pennsylvania Attorney General, however, sought to compel the court to enjoin the Hershey Trust from selling its controlling share in Hershey Foods at least until a hearing could be held on approving any proposed sale.¹³⁰

The Commonwealth Court of Pennsylvania stated that "the Attorney General has the authority to inquire whether an exercise of a trustee's power, even if authorized under the trust instrument, is inimical to the public interest."¹³¹ The Commonwealth Court of Pennsylvania concluded that a merger or acquisition of Hershey Foods most likely would lead to reduced workforces and possible changes in plant locations.¹³²

The court held that the Pennsylvania Attorney General met his burden of proving "the potential harm that he seeks to prevent, namely, the adverse economic and social impact against the public interest if a sale of Hershey Foods Corporation takes place, particularly in its effect of the Corporation and the community of Derry Township."¹³³

127. *See id.*

128. *See In re Milton Hershey Sch. Trust*, 807 A.2d at 325. The Hershey Trust holds 31% of Hershey Foods' common stock as well as 77% of the voting stock. Sarah Ellison, *Hershey Foods' Controlling Trust Says It Has "No Intentions to Sell,"* WALL ST. J., Sept. 27, 2002, at B5.

129. *In re Milton Hershey Sch. Trust*, 807 A.2d at 329.

130. *Id.* at 328.

131. *Id.* at 330.

132. *Id.* at 329. This statement, however, was mere speculation as the court offered no concrete evidence to support it. *See id.*

133. *Id.* at 331.

The court's reasoning is faulty. The attorney general's role as *parens patriae* over charitable trusts is to protect the public as beneficiary of the trust against wrongful actions by the trustees.¹³⁴ In the Hershey Trust's case, the trustees' actions in wanting to sell the controlling interest in Hershey Foods did not harm the public as beneficiaries of the trust. Rather, at most, the sale of Hershey Foods harms the public as other constituencies (as workers, customers, suppliers) of Hershey Foods, *not* the Hershey Trust.¹³⁵ The stated purpose of the Hershey Trust is to fund schooling for underprivileged children residing in certain Pennsylvania counties,¹³⁶ not for the protection of job security for workers employed at Hershey Foods.

The Pennsylvania Commonwealth Court's ruling extends the role of the Pennsylvania Attorney General too far. The Commonwealth Court allowed the attorney general to act *beyond* his *parens patriae* authority. The court's ruling sanctioned the attorney general's political agenda and his aims at vote-getting in central Pennsylvania. In particular, the Pennsylvania Attorney General challenged a legitimate charitable trust action seemingly to push forth his own political career because he was running for governor of Pennsylvania at the same time he tried to stop the Hershey Trust's diversification efforts.¹³⁷

Attorneys general could view numerous legitimate actions as being "inimical to the public interest," especially in election years. An oversimplified hypothetical is useful to demonstrate this point: Consider a charitable trust that has the sole stated purpose to provide funding to artists residing in community X. Community X, unfortunately, is inhabited by many people, all of whom would like to receive funding but only a few of whom are actual artists or appreciate looking at art. This situation could be viewed as "inimical to the public interest" if the public is defined as all of those non-artists living in community X. One should glean from this

134. See generally *Commonwealth v. Barnes Found.*, 159 A.2d 500 (Pa. 1960).

135. But cf. *STATE REGULATION OF CHARITABLE TRUSTS*, *supra* note 79, at 5 ("It is a widely accepted principle that the public is the ultimate or true beneficiary of charitable trusts. Direct beneficiaries are the conduits through which the public receives the benefits of charity.").

136. See Hershey Foundation Deed (Dec. 5, 1935) (on file with author).

137. See *supra* notes 109-13 and accompanying text (discussing the Attorney General's gubernatorial campaign and Hershey-specific campaign advertisement).

example that the attorneys general and the courts should *not* broadly define the public that a charitable trust serves, but rather should define it narrowly in accordance with the trust's stated purpose or the settlor's intent.

C. The Pennsylvania Legislature's Response

The Pennsylvania legislature recently responded to the Hershey Trust situation by amending Pennsylvania's Prudent Investor Rule.¹³⁸ With what could be deemed only a special interest amend

138. 20 PA. CONS. STAT. ANN. § 7203 (West 2002) (amending 20 PA. CONS. STAT. ANN. § 7203 (West 1999)). Pennsylvania's amended Prudent Investor Rule states in relevant part:

(d) Requirements for charitable trusts holding a controlling interest in certain publicly traded business corporations.—

(1) Notwithstanding any other legal requirement or process which may include court review of the activities of a charitable trust, a fiduciary for a charitable trust with beneficiaries at a principal location within this Commonwealth holding a controlling interest in a publicly traded business corporation received as an asset from the settlor shall not consummate any investment or management decision executing a change in the trust's control of that corporation, by sale, merger, consolidation or otherwise, without:

(i) serving notice upon the Attorney General at least 60 days prior to executing the change in control; and

(ii) directing that at least 30 days' prior notice of the execution of the change in control be provided by the corporation to employees of the publicly traded business corporation held by the trust who are located in this Commonwealth.

(2) In addition to any other power or duty provided by law, the Attorney General also has the power to obtain judicial review pursuant to this subsection if the Attorney General concludes that the fiduciary should be prevented from executing such a change in control.

(3) In obtaining judicial approval under this subsection, the fiduciary must prove by clear and convincing evidence that executing the change in the trust's control of the corporation is necessary to maintain the economic viability of the corporation and prevent a significant diminution of trust assets or to avoid an impairment of the charitable purpose of the trust.

(4) In the event court approval is obtained pursuant to this subsection, the court shall ensure that the provisions of 15 Pa.C.S. Ch. 25 Subchs. I (relating to severance compensation for employees terminated following certain control-share acquisitions) and J (relating to business combination transactions - labor contracts) apply to the execution of a change in the trust's control effectuated by the fiduciary of a charitable trust with beneficiaries at a principal location within this Commonwealth holding a controlling interest in a publicly traded business corporation received as an asset from the settlor.

(5) A fiduciary of a charitable trust with beneficiaries at a principal

ment, the legislature granted the attorney general power to order a judicial review if the attorney general believes that the trustees should be stopped from effectuating a change in control of a publicly traded corporation in which a charitable trust holds a controlling share.¹³⁹ When the attorney general obtains this judicial review, then the trustee of such a charitable trust “must prove by clear and convincing evidence that executing the change in the trust’s control of the corporation is necessary to maintain the economic viability of the corporation and prevent a significant diminution of trust assets or to avoid an impairment of the charitable purpose of the trust.”¹⁴⁰

This amendment to Pennsylvania’s Prudent Investor Rule unnecessarily stifles efficient economic transactions. By creating such a high burden of proof—clear and convincing—that the trustees must meet before such a proposed sale could go forward, the Pennsylvania legislature effectively made it more costly for a charitable trust like the Hershey Trust to diversify. Substantially more time and resources would have to be spent from the outset on such things as lawyers, accountants, and financial experts. These additional costs may dissuade trustees from ever acting to diversify. The Pennsylvania legislature turned the attorney general’s role of *parens patriae* in relation to charitable trusts from one of protecting the state to one of protecting certain special interests. This Note urges other states to avoid following the example Pennsylvania put forth in enacting this amendment.

IV. RECOMMENDATIONS ON REDEFINING THE STATE ATTORNEY GENERAL’S ROLE

Although this Note does not propose to curtail completely the state attorney general’s role in overseeing the diversification efforts

location within this Commonwealth holding a controlling interest in a publicly traded business corporation received as an asset from the settlor shall not be subject to liability for the commercially reasonable sale of certain shares of the corporation not necessary to maintain control and for which no control premium is realized if the fiduciary reasonably determined that such sale was authorized in a manner consistent with the requirements of this section and other applicable provisions of this title.

Id. § 7203(d) (footnotes omitted).

139. *See id.* § 7203(d)(2).

140. *Id.* § 7203(d)(3) (West 2002).

of charitable trusts, it proposes a specific procedure that state attorneys general should follow before bringing a potentially unnecessary action to enjoin such efforts to the courts. The state attorney general should be restricted from acting to halt the sale of a charitable trust's investments when: (1) the charitable trust document specifically provides that the trustees have discretion in investing the trust assets, (2) the trustees of the charitable trust wish to fulfill their duty to diversify the trust assets and have acted in a manner consistent with the manner in which a prudent investor would act, and (3) upon examining the process by which the trustees attempt to diversify the trust assets, the attorney general is satisfied that the trustees have acted in such a way as to be protected by something analogous to the business judgment rule. Consistent with the factors described above, the attorney general also should examine whether the trustees' actions to diversify have combatted the settlor's expressed intent in forming the charitable trust.

A. Determining General Investment Powers or Restrictions

When faced with trustees of a charitable trust that want to diversify its trust assets, a state attorney general should first examine the trust instrument to determine the settlor's intent as to the trustees' investment power. If a settlor enumerates which types of investments may or may not be made and a trustee breaches those express provisions, then an attorney general should enjoin the trustee from making those restricted investments. An attorney general acting in such a situation rightfully protects the intent of the settlor. If, however, the settlor grants discretion to a trustee to make investments to sustain the trust, then an attorney general should give deference to a trustee's actions as long as the trustee meets the prudent investor standard.¹⁴¹

If such investments are sanctioned by the trust instrument, the attorney general should not interfere with a trustee's investment decisions or otherwise the attorney general effectively would go

141. See RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE § 227 (1992).

beyond the scope of his *parens patriae* power and instead act as a co-trustee of the trust.¹⁴²

In the case of the Hershey Trust, this is exactly what the Pennsylvania Attorney General accomplished. No express provision in the trust existed that restricted the trustees from selling the Hershey Trust's controlling share of Hershey Foods.¹⁴³ Rather, the trustees acted within the discretion that Mr. Hershey had granted them in the trust instrument.¹⁴⁴

*B. Determining Restrictions on Sale of Inception Assets*¹⁴⁵

1. Express Restrictions

A trustee's decision to retain or to sell the trust's original investments—those given to the trust at its beginning—may depend on the “property's special relationship to some objective of the settlor that may be inferred from the circumstances.”¹⁴⁶ The most evident circumstance occurs when the trust instrument specifically states a restriction on selling the inception assets. This would make for an easy case for the attorney general—absent some other legal theory permitting the sale of those assets, the attorney general should seek to enjoin the trustees' attempt to diversify by disposing of such assets.

To illustrate the legal effect of such express restrictions, it is helpful to compare the situation present in *Commonwealth v. Barnes Foundation*¹⁴⁷ to that of the Hershey Trust. In *Barnes*

142. See, e.g., *In re Milton Hershey Sch. Trust*, 807 A.2d 324, 337 (Pa. Commw. Ct. 2002) (Pellegrini, J., dissenting) (indicating that the Attorney General lacks power “to essentially act as co-trustee or co-manager of the Trust and be part of the process leading up to a decision by the Trustees to take a certain action”); see also *supra* notes 95-96 and accompanying text.

143. See Hershey Foundation Deed (Dec. 5, 1935) (on file with author).

144. See *id.*

145. See *supra* notes 59-60 and accompanying text.

146. RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE § 229 cmt. a (1992). That special relationship does not need to be stated expressly in the trust instrument. *Id.* Arguably, no implied intent existed on the part of Mr. Hershey to restrict the sale of the Hershey stock. This may be inferred from the fact that Mr. Hershey set up this trust to provide educational benefits to poor children, not to provide complete well-being to the entire Hershey community.

147. 159 A.2d 500 (Pa. 1960).

Foundation, the Attorney General charged the trustees with failing to meet the mandates of their governing trust instrument.¹⁴⁸ The Barnes Foundation is a charitable foundation that holds the art collection amassed by Dr. Albert Barnes and serves as an art education center.¹⁴⁹ In contrast to the Hershey Trust instrument, the Barnes Foundation indenture "outlined a severely limited investment policy for the Foundation's endowment. The Indenture strictly forbade charging entrance fees to the collection, the construction of new buildings on the Foundation's premises, and the loan or sale of any of the paintings under any circumstances short of physical deterioration."¹⁵⁰

The instrument forming the Hershey Trust, on the other hand, did not restrict the sale of the inception assets—the Hershey common stock—like the Barnes Foundation indenture did with the inception assets of the artwork collection. No language existed in the Hershey Trust instruments to warrant the Attorney General's conclusion that the trustees failed to meet the mandates of the trust instrument.

Instead, the instrument defining the Hershey Trust gave the trustees discretion to make investments and did not mandate that the trustees hold on to the Hershey shares granted to the trust at its inception.¹⁵¹ Ultimately, in the case of the Hershey Trust, the Pennsylvania Attorney General was unable to point to any specific trust language that the trustees breached but rather could only amorphously allege that the trustees' actions harmed the public as beneficiaries.¹⁵² Such baseless allegations, while perhaps helping to

148. *Id.* at 505 (stating that the trustee defendants denied public access to an art gallery as mandated in the trust). In other Pennsylvania cases that were examined, the Attorney General usually made a specific allegation that the trustee failed to execute a provision in the trust instrument or failed to use the trust assets to achieve the purpose that the settlor intended. *See, e.g.*, *Valley Forge Historical Soc'y v. Washington Mem'l Chapel*, 426 A.2d 1123 (Pa. 1981); *Abel v. Girard Trust*, 365 Pa. 34 (1950); *In re McCune*, 705 A.2d 861 (Pa. Super. Ct. 1997); *Cain Estate*, 16 Pa. D. & C.3d 50 (C.P. Ct. Delaware County 1980).

149. Chris Abbinante, Comment, *Protecting "Donor Intent" in Charitable Foundations: Wayward Trusteeship and the Barnes Foundation*, 145 U. PA. L. REV. 665, 670-71 (1997).

150. *Id.* at 672 (citations omitted). The Barnes Foundation is a good example of when preserving the value of the trust assets also equals preserving the value of the property granted to the trust (namely, the artwork). *See supra* Part I.D.4.

151. *See supra* notes 125-27 and accompanying text.

152. *See supra* note 132 and accompanying text.

further the Attorney General's political career, only frustrated the intent of the settlor.

2. *Implied Restrictions*

Even in the absence of an attorney general finding express language of a trust that restricts a trustee from making investment decisions in general¹⁵³ or in particular with the trust's inception assets,¹⁵⁴ the attorney general should still look at whether the sale of the assets is "inimical to the public good" because this sale would be inimical to the *charitable purpose* of the trust. Determining whether a sale of assets would be inimical to the trust's charitable purpose should be defined narrowly. If attorneys general have wide latitude to determine whether a trustee's investment actions are inimical to the public, then the risk arises of having the attorneys general use that power for their own political motivations.¹⁵⁵

Accordingly, the attorney general should not look at the identity of the investment at all. Instead, the attorney general should focus on the use of the income from the trust assets. A simple example may help clarify how Hershey common stock does not serve a special purpose to the trust, like artwork, a farm, or a particular building would serve another trust. To reiterate, the Hershey Trust's purpose is to provide schooling for underprivileged children, with preferences given to children residing in certain counties in Pennsylvania.¹⁵⁶ Initially to fund that purpose, Mr. Hershey granted common stock shares in Hershey Foods.¹⁵⁷ These fungible shares serve no special purpose to the trust.

To illustrate, a share of stock in Corporation *ABC* that is worth \$100 and pays annual dividends of \$5 has the same purchasing power as a share of stock in Corporation *XYZ* that is also worth \$100 and pays annual dividends of \$5. Both of *ABC*'s and *XYZ*'s shares may serve the purpose of paying expenses of running a school for underprivileged children. In contrast, if a settlor, like Dr. Barnes, grants his artwork collection for the purpose of showing

153. See *supra* Part IV.A.

154. See *supra* Part IV.B.1.

155. See *supra* Part II.D.

156. Hershey Foundation Deed (Dec. 5, 1935) (on file with author).

157. *Id.*

this collection to the public, then those inception assets serve a special purpose to the beneficiaries and the trustees' decision to sell the artwork would contravene the settlor's intent.

C. Examining the Diversification Process: Analogy to the Business Judgment Rule

If the state attorney general has not found any restrictions on investments and particularly any restrictions on sales of inception assets, then the next step the attorney general should undertake is to investigate the specific process the trustees used or plan to use to diversify the trust assets. In this step, something analogous to the business judgment rule should guide the attorney general's inquiries. In the corporate law realm, the business judgment rule provides protection for corporate directors from unwarranted intrusion by disgruntled shareholders.¹⁵⁸ The business judgment rule operates as follows:

If the directors are entitled to the protection of the [business judgment] rule, then the courts should not interfere with or second-guess their decisions. If the directors are not entitled to the protection of the rule, then the courts scrutinize the decision as to its intrinsic fairness to the corporation and the corporation's minority shareholders. The rule is a rebuttable presumption that directors are better equipped than the courts to make business judgments and that the directors acted without self-dealing or personal interest and exercised reasonable diligence and acted with good faith.¹⁵⁹

In corporate settings, the Pennsylvania legislature defined that a director of a corporation has a duty of care to "perform his duties as a director ... in good faith, in a manner he reasonably believes to be in the best interests of the corporation and with such care, including reasonable inquiry, skill and diligence, as a person of ordinary prudence would use under similar circumstances."¹⁶⁰

158. *Keyser v. Commonwealth Nat'l Fin. Corp.*, 675 F. Supp. 238, 257 (M.D. Pa. 1987) (quoting *Enterra Corp. v. SGS Assocs.*, 600 F. Supp. 678, 685 (E.D. Pa. 1985)).

159. *Gries Sports Enters., Inc. v. Cleveland Browns Football Co.*, 496 N.E.2d 959, 963-64 (Ohio 1986).

160. 15 PA. CONS. STAT. ANN. § 512(a) (West 2002).

A state attorney general may use something analogous to the business judgment rule as guidance in deciding whether to call for injunctive relief or judicial review of a trustee's proposed diversification efforts. In order for the attorney general to examine the *process* by which the trustees of a charitable trust wish to diversify, the attorney general must make sure that the decisions the trustees made were in good faith and absent any wrongdoing.

Specifically, an attorney general may satisfy himself that the trustees acted in good faith in making their decision to diversify by examining whether the trustees sought legal advice, obtained a fairness opinion from a financial expert as to the value of the trust's investments, negotiated with potential buyers, and, in a situation like the Hershey Trust where the investment constitutes a controlling block of stock, whether the trustees shopped this control block around to potential buyers in order to receive the best price.

If the attorney general is satisfied that the trustees acted in good faith and absent any wrongdoing, then this analogy to the business judgment rule will apply to the actions undertaken by the trustees and will protect the trustees from any judicial review of their actions. If the attorney general finds that the trustees indeed acted in bad faith and with a corrupt motive, then the attorney general may press forward and demand a judicial review of the trustees' actions to diversify.

The duty of care that underlies the business judgment rule presumption in corporate settings has two aspects: procedural due care and substantive due care.¹⁶¹ Procedural due care only permits judges to determine whether directors are protected by the business judgment rule by examining whether "the process employed was either rational or employed in a *good faith effort* to advance corporate interests."¹⁶² In contrast, "a breach of substantive due care occurs when a challenged action, viewed *ex post*, seems so outrageous or inherently risky that it is simply impossible to imagine how the directors could have reached that decision other than as a result of lack of due care or skill."¹⁶³

161. See, e.g., *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 966-70 (Del. Ch. 1996).

162. *Id.* at 967.

163. CHARLES R.T. O'KELLEY & ROBERT B. THOMPSON, CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS 317 (3d ed. 1999); see also *Grobow v. Perot*, 539 A.2d 180, 189 (Del.

An attorney general should concentrate his efforts on examining the process by which the trustees made their decisions. An attorney general, however, when faced with a decision that was so "outrageous" should also be able to bring suit against the trustees despite whether the process used passed the attorney general's investigations.¹⁶⁴

D. Refraining from Action

If the process by which the trustees of a charitable trust plan to diversify the trust assets is protected by something analogous to the business judgment rule, then an attorney general should not be able to appeal to the possible outcomes of sale of the controlling shares, such as possible layoffs due to merger, plant closings that would reduce state tax revenue base, and so forth. This does not and should not matter.¹⁶⁵

The attorney general, under the guise of his *parens patriae* powers, cannot mandate that a charitable trust holding a controlling block in a company such as Hershey Foods consider other constituencies in the decision to sell its shares.¹⁶⁶ In Pennsylvania, the board of directors of a corporation *may* consider constituencies other than its shareholders in its decision to sell the corporation.¹⁶⁷

1988) (rejecting plaintiff's argument that stock repurchase was so egregious that it should not be protected by the business judgment rule); *Litwin v. Allen*, 25 N.Y.S.2d 667, 697-99 (Sup. Ct. 1940) (holding that the actions of a bank's directors, which included the purchase of securities that benefitted only the seller and not the bank, were violative of substantive due care).

164. A criticism of substantive due care is that it "would expose directors to substantive second guessing by ill-equipped judges or juries, which would, in the long run, be injurious to investor interests." *In re Caremark*, 698 A.2d at 967. The same criticism applies to this Note's proposal to allow the attorney general to opt for a substantive due care challenge to the outcome of the trustees' actions. Yet this option will not permit the attorney general to challenge just any poor outcome. Instead, the attorney general would have to show that the outcome was "so outrageous or inherently risky." See O'KELLEY & THOMPSON, *supra* note 163, at 317.

165. Although the author of this Note understands the effects of layoffs on workers and the effects of plant closings on the local community, markets have the best ability to allocate resources efficiently.

166. Cf. 15 PA. CONS. STAT. ANN. § 515 (West 2002). This statute *permits*, rather than *mandates*, a corporation's board of directors to consider constituents other than shareholders in a major decision affecting the corporation. See *id.*

167. *Id.* The statute states in relevant part:

In discharging the duties of their respective positions, the board of directors,

Borrowing from this corporate law other constituencies statute, the attorney general—in using his *parens patriae* powers—*should not* be able to *mandate* that the trustees of a charitable corporation consider other constituencies (like employees, customers, suppliers, the community) of the company in which it holds shares when deciding to diversify by selling those shares.

E. Counterarguments and Alternative Solutions

One may argue that this Note's proposal to confine the attorney general to looking only at whether the process by which trustees of a charitable trust try to diversify is valid and thus affords the trustees protection under something analogous to the business judgment rule is unworkable. This argument would focus on the attorney general's role of protecting the public against breaches of duties by trustees and the increased costs to monitor charitable trusts as compared to corporations.¹⁶⁸

Likewise, one may suggest that a settlor of a charitable trust may avoid imposing such obstacles on the trustees of a charitable trust by setting up the trust with an already diversified portfolio. In this way, the settlor will take the attorney general out of the picture with regards to questioning the trustees' diversification efforts because the trust will not hold a controlling share of a publicly traded corporation at its inception. In situations such as the Hershey Trust, where legislation such as Pennsylvania's Prudent Investor Rule affects the decisions of charitable trusts already established, this solution will not be viable.

Another possible solution is that legislatures could extend standing to other parties with a special interest in the charitable trust, such as shareholders of the corporation in which the charita-

committees of the board and individual directors of a domestic corporation *may*, in considering the best interests of the corporation, consider to the extent they deem appropriate:

- (1) The effects of any action upon any or all groups affected by such action, including shareholders, members, employees, suppliers, customers and creditors of the corporation, and upon communities in which offices or other establishments of the corporation are located.

Id. § 515(a)(1) (emphasis added).

168. See generally Manne, *supra* note 116 and accompanying text (discussing agency costs involved in the oversight of charities).

ble trust owns a controlling share. This still would be a fairly unviable solution because a corporation's shareholders are often numerous, thus increasing the potential for a trust to face much litigation. Moreover, the shareholders would seek to protect their interests in the corporation, even though those interests may not necessarily be aligned with the interests of the charitable trust.

CONCLUSION

An attorney general's power to effectuate a politically charged outcome must be limited in those instances in which trustees of a charitable trust want to diversify the trust assets, pursuant to an express provision of the trust document allowing investment discretion. An attorney general should not block that diversification effort just because some indirect form of public harm potentially may occur. If allowed to do so, the attorney general would have exceeded his *parens patriae* powers and assumed the role of a co-trustee.¹⁶⁹ Instead, the attorney general should focus his investigatory efforts to make sure that (1) the trust instrument granted investment discretion to the trustees, and (2) the trustees, in their process of diversifying the trust assets, fulfilled their fiduciary duties in such a way that they would be protected by something analogous to the business judgment rule. By ensuring that the trustees have met those factors, the attorney general would not have exceeded the scope of his *parens patriae* power.

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169. See *supra* notes 95-96, 142 and accompanying text.