GOVERNANCE ISSUES THAT MAY TRIGGER AG INVOLVEMENT[1]

VICTORIA B. BJORKLUND
SIMPSON THACHER & BARTLETT LLP

I. POWER OF THE PRESS

A. Boston Globe Spotlight Series

Beginning in October 2003, the Boston Globe spotlight team wrote a series of approximately 15 articles focused on alleged excessive compensation, perquisites, abuse of power, and other views drawn primarily from IRS Forms 990-PF with follow-up interviews. This series showed the power of the IRS Form 990 when combined with the press and the telephone. The Globe team identified perhaps two dozen targets for IRS and state regulators. For a sampling of the articles, see Appendix A.

Probably the most-cited of the Globe articles is the one featuring Paul Cabot who reported raising his annual salary to $1.4 million in part because of the cost of his daughter's wedding. An interesting exercise is to compare the points in the Globe story with the publicly-available source material, the IRS Forms 990-PF for the Paul and Virginia Cabot Charitable Trust. Those Forms show the reader that the Trust had an unusually high expense-to-grants ratio. The grantmaking activity appeared by dates of the checks to be concentrated in a few months of the year and the grants seemed straightforward, raising questions as to whether the salary described in the Forms was "reasonable and necessary" for the services rendered, as required in the self-dealing regulations.

But all stories have two sides and many of the Boston Globe stories did not lead to findings after investigations were completed. For those that resulted in findings, the follow up was especially informative. For example, on December 16, 2004, the Boston Globe ran a follow-up article reporting the announcement by the Massachusetts Attorney General's Office that Mr. Cabot had agreed to repay over $4 million to the Foundation and be barred for life from future charity board service. See Appendix B.

---

[1] This outline builds upon "The Emergence of the Donor-Advised Fund," presented at Georgetown University's 2005 Annual Conference on Representing and Managing Tax-Exempt Organizations.

In a January 25, 2004, letter to the editor of the Globe, Dorothy Ridings, then-President of the Council on Foundations, said:

> "I commend your spotlight team for its series of articles on abuses among some private foundations that began last October 9.... Your newspaper consistently posited two important facts:
>
> "The vast majority of the roughly 62,000 private trusts established in the U.S. operate honestly.
>
> "Negligible enforcement of existing laws by the IRS makes it too easy for a relative handful of foundations to abuse the public trust. The unfortunate possibility is that Congress could punish all foundations because of the acts of this irresponsible minority...."

Then-IRS Commissioner Mark Everson shortly thereafter increased IRS enforcement:

- new IRS audit agents were hired;
- new fraud units were set up to mine data;
- 16,000 "soft contract letters" were sent in 2005; and
- 2000 compensation audits were completed.

Negative publicity of this kind has also led to several Congressional hearings and the convening by the Independent Sector of the National Panel on the Non-Profit Sector. The downside of negative publicity is that it can be damaging to public perception of good charities.

II. Actions By State Regulators

A. NYS AG's Proposals. In comments dated March 26, 2003 to the Oversight Committee on Ways and Means, William Josephson and Karin Kunstler Goldman of the NYS Attorney General's Charities Bureau proposed to "Phase Out Small Private Foundations":

> "In New York, private foundations raise far more compliance issues than do publicly supported charities, particularly the smaller private foundations.
>
> "At the least, all private foundation exemption determinations should be provisional and should not be renewed without advice from the relevant state charities regulators specifically as to...whether or not the charities are active, their registration and reports are current and fair on their face, have been the subject of complaints, or are under investigation."

They also recommended amendments to the Internal Revenue Code that would:

(1) Deny tax exemption to private foundation applicants that have less than $20 million in net investment assets at inception and/or

(2) Phase out over ten years the exempt status of private foundations with less than $20 million in net assets.

(3) They would expect an increase in the number of donor advised funds if these proposals are enacted, seeing them as offering "a professionalism and responsibility that few small private foundations can match."

These proposals did not lead to legislation, although the Pension Protection Act of 2006 doubled the penalty amounts applicable to private foundations and enacted new penalties for abuse of donor advised funds.

B. Examples of Actions By Attorneys General.

1. New York. AAG Josephson circulated a list dated March 10, 2003, entitled "Examples of Board Failure Identified by the Attorney General of the State of New York" (see Appendix E). Those examples included public charities and private foundations. Case 1 is the Grand Marnier Foundation. 2004 news reports indicate that the case was settled in an agreement which called for replacing several board members and repayment of funds received by the prior directors.

2. Missouri. On March 4, 2004, Missouri Attorney General Jay Nixon released a press statement and governance report on the Ewing Marion Kauffman Foundation. The title of the press statement, "Nixon Review of Kauffman Foundation Recommends Changes to Ensure Kansas City Ties and Benefits," is reminiscent of the action in Pennsylvania that blocked the Hershey Trust board from diversifying its assets to the potential detriment of residents of Hershey PA. Attorney General Nixon's statement and report run 13 pages. The Foundation replied to his recommendations on September 1, 2004. See www.kaufman.org. An amicable resolution followed.

3. Texas. On June 11, 2004, a Texas jury returned a $21 million verdict against two former officers of the Carl B. and Florence E. King Foundation. One of the officers was the grandson of the original donors. The charges of excessive compensation and excessive reimbursement of expenses were brought by the current Board of Directors and the Texas Attorney General. The jury directed the two defendants to repay $7.5 million to the Foundation and to pay $14 million in punitive damages.

4. Illinois. Illinois Attorney General Lisa Madigan is seeking to recover $9 million in commissions and fees and $32 million in depleted assets from Bielfeldt family members. Those amounts were allegedly wrongfully paid by the Bielfeldt Foundation to disqualified persons or lost through their improper management. Papers were amended in 2007 by the Attorney General.

APPENDIX A

SPOTLIGHT REPORT | CHARITY BEGINS AT HOME

The Boston Globe

Some officers of charities steer assets to selves

By Globe Staff, 10/9/2003

This article was reported and written by the Globe Spotlight Team: Reporters Beth Healy, Francie Latour, Sacha Pfeiffer, and Michael Rezendes, and editor Walter V. Robinson.

First in a series of occasional articles.

When Jennifer Felton Cabot was married in November 2001, in Boca Grande, Fla., where her parents have a winter compound on the Gulf of Mexico, the wedding announcement appeared in The New York Times. And her father, Paul C. Cabot Jr. of Needham, made sure the ceremony was a top-shelf event. The wedding, he said this week, cost almost $200,000.

Now, questions about the source of the $200,000 may eclipse the wedding memories. Cabot, the son of legendary Boston investment banker and Harvard treasurer Paul C. Cabot, paid for the wedding by using funds from a foundation his late father established to benefit tax-exempt charitable causes.

For Cabot, charity indeed begins at home: From 1998 through 2002, he tapped the assets of the Paul and Virginia Cabot Charitable Trust, of which he is a trustee, to pay himself $5,185,216. His annual salary topped out at $1.4 million in 2001 -- a year in which, he says, he gave himself a raise to help pay for the wedding.

During the same five years, Cabot donated an average of $400,000 a year to charities; and the foundation's assets have now dwindled to $5 million.

The vast majority of private charitable foundations -- there are more than 60,000 of them in the United States -- are governed by trustees who take no compensation at all. But an investigation by the Globe Spotlight Team has found scores of foundations whose tax returns show that officers and directors are themselves the principal beneficiaries of foundation assets that are intended for charitable causes.

In some cases, pay to foundation officers exceeds annual donations, draining away funds that could otherwise support hard-pressed charities. Federal rules governing foundations require that any compensation be "reasonable."

Some examples that appear to flout that federal guideline:

- A gilded retirement package for the head of The William T. Morris Foundation of New York. The foundation more than tripled its president's compensation to more than $900,000 between 1997 and 2001. An $88,000-a-year foundation employee also doubles as a driver for the president, who is 86 and semiretired.

- The Hocker Foundation of Rancho Santa Fe, Calif., which wrote just three grants over four years, a total of $265,000 that all went to one charity, a hospital. During the same four years, the trustee, who lists himself as a full-time employee, was paid $580,000. He also violated rules governing private foundations when he took a personal loan from the foundation for $200,000, which he repaid.

- A San Francisco-area foundation, Franklin Holding Corp., paid its chairman $3.5 million in 1998. That year, its charitable donations amounted to just $1.6 million, all of that donated to a hospital.

- The Lucille and Vic Wertz Foundation of Chicago, endowed by Wertz, a one-time Red Sox and Detroit Tigers slugger. After Wertz's widow died, her two brothers took control of the foundation. Over one recent five-year stretch, they paid themselves more than $1 million in trustee fees from the $7 million in assets, while donating only to $175,000 to charities. Wertz's philanthropic focus on youth groups has been largely abandoned. The brothers, Richard T. and George T. Caleel, did not respond to repeated requests for an interview.

▪ The Gerda Lissner Foundation in New York was created to give grants to talented young opera singers, but its assets have dropped from $16.2 million to $12.4 million since 1998. During the same period, foundation director Betty Smith's salary has more than doubled, from $114,583 to $281,153. Smith said the foundation's board decided the raises were merited. But one of the board's directors, Edmund W. Badgley, said he never voted for any increase, and expressed surprise at Smith's compensation. Smith said Badgley was not present at meetings in which the raises were approved.

The world of foundations and trusts is regulated by the Internal Revenue Service and state attorneys general. But in practice, these charitable organizations operate virtually without scrutiny. The IRS audits only about 120 private foundations a year. And few states have the resources to keep track of the annual tax returns that flood their offices.

In an interview yesterday, Jamie Katz, chief of the Massachusetts attorney general's public charities division, said that because of an "antiquated database," his office does not even know how many private foundations -- those established by individuals -- there are among the 22,000 public charities in the state. And because private foundations operate largely out of public view, Katz said, complaints about them are rare.

Foundation directors defend hefty annual fees, even when their roles require only occasional involvement. And there are many whose roles fit that description.

A Globe analysis of public federal tax filings by thousands of foundations found hundreds of cases around the country where people who oversee charitable foundations received tens of thousands -- and sometimes hundreds of thousands of dollars -- for attending a handful of annual meetings.

In some instances, the tax returns show that well-paid directors worked "zero" hours. In others, the duties are minimal.

For example, the charter of a $28 million Philadelphia foundation, the George Jr. and Harriet E. Woodward Trust, dictates that the same seven charities receive the same grants each year. Nonetheless, payments to the two trustees averaged more than $100,000 a year between 1998 and 2002.

And in Danville, Va., the three non-bank trustees of the $21 million Carrington Charitable Trust have received annual fees averaging more than $40,000 each, even though the foundation tax returns report that they spend just 15 minutes a week on foundation business. That's a compensation rate of more than $3,350 an hour.

In an interview last week, trustee B. Carrington Bidgood said the tax return actually overstates his commitment. "Five minutes," he replied when asked how much time he devotes weekly to the foundation. "I don't keep track of all that. We have one meeting a year, and that's all," Bidgood said.

In the face of inaction by the Internal Revenue Service and state regulators, even obvious cases of excessive compensation almost always escape official notice. Cabot, for instance, said that his compensation has never been challenged by either the IRS or the office of Attorney General Thomas F. Reilly. "The foundation's tax returns have been sitting in the AG's office since day one. And they haven't ever raised any clamor," Cabot said.

In most cases, it takes a complaint to prompt official action. In Texas and Ohio, attorneys general launched investigations of two private foundations, but only after family members complained about alleged plundering of the assets by foundation officials. State officials say the IRS has not yet taken up either case.

At both foundations, the Globe found, the alleged wrongdoing was more extensive than has been reported in local newspapers.

In one, involving the Charles H. Dater Foundation of Cincinnati, records in a civil lawsuit contain evidence that the foundation's five directors, three of them Merrill Lynch brokers, took legal and director's fees and brokerage commissions of at least $9 million over several years. At least $2 million of that came from commissions the stockbrokers earned by frequent buying and selling of stocks for the foundation and the Dater estate, the lawsuit says. Last year the foundation had assets of $40 million.

Despite such publicized examples of alleged abuses by foundation officials, calls for greater regulation of the industry have had little effect. Congress last month backed away from imposing substantial new restrictions on private foundations after heavy lobbying by foundation officials.

But the Globe investigation, which used a computer database to sort through tens of thousands of tax returns filed annually by private foundations, found that the abuses are more extensive and deeply rooted than government regulators and foundation experts have thought.

Especially among smaller foundations, those with assets under $20 million, the Globe found numerous cases in which the officers and directors receive more money than the foundations award in charitable grants.

Bruce R. Hopkins, a Kansas City lawyer and author of "Private Foundations," a detailed survey of foundation tax law and compliance, expressed astonishment at some of the Globe findings, especially the compensation taken by Cabot and the president of the Morris Foundation.

In both cases, he said, the pay is excessive, based upon the legal standard that compensation for foundation officers must be "reasonable" -- and reasonableness is determined by what other people doing the same sort of foundation work would receive.

Hopkins, when told that Cabot acknowledged boosting his salary to $1.4 million to pay for the wedding, said such practices are appalling but not unheard of in foundations. "You have this mindset in some quarters that if you need the money, you dip into it," he said. "That's not the way it works. These are charitable dollars, and they ought not to be spent that way."

Cabot's father, Paul Codman Cabot, who died in 1994, was a paragon of Brahmin frugality. A founder of State Street Research & Management Co., Cabot was said to be so indifferent to his station in life that he worked out of a sparsely furnished office and wore shirts with frayed collars.

Paul Cabot Jr., who is now 73, said this week that he took only modest compensation, which he estimated to be $50,000 to $60,000 a year, from the foundation until a New York energy company of which he is chairman began to have financial difficulties in the mid-1990s.

In 1998, the earliest year for which the Globe has the foundation's tax return, Cabot paid himself $510,202. The next year, he gave himself a $370,000 raise -- to $880,263. In 2000, he paid himself $1,058,233. For the year of the wedding, he increased his salary to $1,418,278. Last year -- the foundation's fiscal year runs from Feb. 1 to Jan. 31 -- Cabot took a slight pay cut, to $1,318,240.

During three interviews this week, Cabot chose to explain, rather than defend, his compensation, describing it as "probably excessive" and "a little more than reasonable." He decided to take such a high salary, he said, because he needed the money. By his own estimate, Cabot said he could probably hire a financial manager for less than $100,000 a year to oversee the investments. The grant-making, according to the tax returns, is almost pro forma: Year in and year out, most of the money goes to the same charities.

Cabot, who has long worked in the investment management field, said he manages the foundation's portfolio himself. But under his stewardship the foundation's assets have dropped from $14 million in the mid-1990s to $4.9 million early this year, according to the foundation's most recent tax return.

Some of that decline was the result of his high salary. But Cabot attributed the drop in asset value in large part to a bad investment decision: He put 30 percent of the assets into two energy stocks, El Paso Energy Corp. and Duke Energy Corp., he said, only to see the stock shares plummet. "I got my head handed to me," Cabot said.

When the Globe first asked him about the raise he gave himself in 2001, Cabot said he did so "because I had to marry off a daughter and it took a little bit more than I had anticipated." At first, he said the wedding cost $118,000, but later said its actual cost was about $200,000. "Things don't come cheaply in Florida," he explained.

Asked if the foundation paid for the wedding, Cabot replied: "Yes. No question. The foundation pays for anything I do."

If Cabot now faces a public accounting, he may also have to answer questions from his brother and his two sisters. The sisters, Virginia C. Wood and Elizabeth C. Minot, are unpaid cotrustees of the foundation. Even so, Cabot said his siblings are unaware of his high salary. He said he sends his sisters only a list of the charitable donations each year.

Under IRS regulations Cabot could be forced to repay the foundation, with penalty, any amount that is judged to be unreasonable compensation. His two sisters, because they are trustees, could also face fines if the IRS takes action.

The cost of charity is also steep at the William T. Morris Foundation. In 2001, the last year for which a tax return is available, the New York City foundation spent $2.8 million to give away $1.8 million, with the salaries of top officials rising rapidly even as the foundation's assets diminished.

The foundation wrote checks to just 28 charities in 2001, the vast majority of them repeat recipients.

By far the foundation's largest cost is the pay and perquisites for Edward A. Antonelli, the foundation's longtime president, who is 86, and Bruce A. August, the foundation's second-ranking official. In 2001, Antonelli received $809,750 in salary and $121,312 in benefits; August was paid $736,750 in salary, $110,362 in benefits.

Between 1995 and 2001, Antonelli's salary quadrupled.

But there are other costs to support Antonelli. Amol Patil, who received $88,000 in salary and $12,000 in benefits in 2001 as a "portfolio manager" at the foundation, told the Globe in an interview that he also doubles as Antonelli's driver.

Patil also said Antonelli "still plays an active role" in the foundation. But Carol Panagi, Antonelli's landlord and neighbor in the four-unit apartment building in Bayside, Queens, where Antonelli lives. Panagi said that Antonelli rarely leaves his apartment, except when a driver comes to pick him up.

Because of Antonelli's failing eyesight, Panagi said, he no longer drives. "His health isn't the greatest," Panagi said. "I know he can't see because he bashed his car into my garage several times.... People are driving him back and forth, running errands, maybe taking him to the office, or what have you."

In a brief interview at his home, Antonelli acknowledged his role as president of the foundation, but refused to answer any questions about it. "Write a letter!" he snapped shortly before slamming the door shut. "This is not my place of business."

August, reached by telephone at his home in Westport, Conn., also refused to answer any questions, other than to deny that Patil serves as Antonelli's driver. August said he would consider questions only if they were sent to him in writing, by mail. He said he would not consider questions sent by fax or e-mail.

Two of the Morris Foundation's part-time directors, both of them elderly, said they were unable to shed much light on the foundation's operations. Arthur C. Laske Jr., of Trumbull, Conn., who is listed as the Morris Foundation's treasurer, said he knows nothing about the foundation's finances. "I don't get involved with those figures at all," Laske said.

The other director, Wilmot F. Wheeler Jr. of Southport, Conn., when asked whether Antonelli's compensation is appropriate, said: "I do have an opinion about it. But I'm not going to give it to someone who is calling me on the telephone." When a reporter went to his home to talk in person, Wheeler refused to be interviewed.

Cabot, in contrast, was agreeable to answering questions, although last night he said his lawyer had told him "to shut up. I have broken no laws." And he made it clear he has taken such a large slice of the foundation's assets to maintain an affluent lifestyle.

Just for his living expenses, Cabot said, he needs after-tax income of $30,000 a month. "My wife, I give her $10,000 a month, too. She seems to think it's not enough, like most women," he added.

He said he still has mortgages to pay, although he and his wife, Jennifer, have substantial property holdings: They bought a $1.3 million home in Needham in 1996. The same year, they bought two waterfront lots and built two homes on a barrier island in Boca Grande. The two homes have an assessed value of $2.2 million. His wife also owns a 25-acre waterfront home in North Haven, Maine, that is assessed for tax purposes at $1.48 million.

One major reason he takes such a large salary, he said, is because of the high taxes he is forced to pay on his salary. "Thanks to the tax code, that's why the salary figure seems so inflated.... The only way I can pay my taxes is to take more money out of the [foundation]. "

To underscore that point, Cabot read to a reporter from his own personal tax return for 2002. "My adjusted gross income was $1,337,000. And the total tax was $470,000."

Cabot said, however, that he realizes that drawing such a large salary would eventually empty the foundation's coffers, although he said the rising market has bolstered its assets some. For this year, he said, he hopes to reduce his salary. "I hope it will be under $1 million," he said.

"I do not squander this money on Ferraris or 85-foot yachts," Cabot said. "I live a fairly modest life."

Matt Carroll of the Globe Staff contributed to this report.

Mass., 2 other states to probe foundations

The Boston Globe

By Sacha Pfeiffer and Michael Rezendes, Globe Staff, 10/10/2003

Massachusetts Attorney General Thomas F. Reilly and the top prosecutors in two other states yesterday said they would open inquiries into possible financial wrongdoing by the heads of several charitable foundations, including some whose hefty compensation packages eclipsed what the foundations gave to charity.

"We are clearly not happy when a fiduciary of a charity believes that he or she can use charitable assets as if they're personal funds available at their whim or pleasure without any regard for the charitable mission of the organization," said Jamie Katz, chief of Reilly's public charities division, which regulates foundations. "We've taken action against fiduciaries who have treated charitable assets as their own, and we expect to do so in the future."

Katz and the offices of New York Attorney General Eliot Spitzer and California Attorney General Bill Lockyer were reacting to yesterday's Globe Spotlight Team report on foundations whose officers and directors have dipped freely into foundation assets meant for charitable causes.

Among the foundations cited was the Needham-based Paul and Virginia Cabot Charitable Trust, whose dwindling assets were used to pay trustee Paul C. Cabot Jr. a salary of more than $5 million from 1998 to 2002 and to fund a $200,000 wedding for his daughter. Cabot did not return a phone call yesterday, but in earlier interviews he said he had "broken no laws."

Katz said the attorney general's public charities division will "review everything that came to light" in the Globe stories to "determine what further information we need or what actions are appropriate."

He said his office would focus on whether charitable assets are being used in a way that is consistent with a charity's mission, whether the operation of a charity results in any conflicts of interest, and whether officers and trustees have received unreasonably high compensation.

Sanctions for violations can include requiring trustees to reimburse foundations for excessive compensation, removing officers and trustees, and requiring foundations to enter governance agreements with the attorney general's office, Katz said.

He said the state cracks down on foundation abuses when they are brought to light, but does not have the resources to adequately police the many such institutions in the state.

In New York, Spitzer's office said it would review the records of two New York foundations described by the Globe as paying excessive compensation to its trustees: the William T. Morris Foundation and the Gerda Lissner Foundation.

William Josephson, the assistant attorney general in charge of Spitzer's charities bureau, said that if the office believes unjustified compensation was paid to any of the foundation trustees it will "launch a formal investigation and start taking measures."

Josephson also said his office would examine the records of every foundation cited in the Globe report to determine if any of them raise money or bank assets in New York, which could give the New York attorney general's office authority over them. "We're very concerned about the abuses we're seeing," Josephson said.

In California, Lockyer's charities division is reviewing findings by the Globe that the presidents of Franklin Holding Corp. of Walnut Creek, Calif., and the Hocker Foundation of Rancho Santa Fe, Calif., took personal loans from the foundations they run, according to special assistant attorney general Tricia Wynne. Both foundation chiefs also took pay that appears to have been excessive, relative to compensation paid by similar foundations.

Meanwhile, the heads of several local nonprofit charitable organizations and specialists in foundation administration voiced outrage at the excesses turned up by the Globe investigation, which was based in large part on the newspaper's analysis of thousands of federal tax returns filed by private foundations.

At Dorchester's Codman Square Health Center, which relies on foundation grants and government funding, executive director Bill Walczak said he was angered by the high trustee compensation reported by the Globe.

"How can anyone justify spending more in overhead than they actually give out? That's immoral," Walczak said. "I think the attorneys general have not been on their guard for the potential for abuse in philanthropies."

Thomas A. McLaughlin, a senior manager in the nonprofit practice at the Boston office of Grant Thornton, a national accounting firm, also expressed consternation at the array of abuses detailed.

"While I still believe that the majority of trustees hold themselves to a high standard, those who don't have tainted them all," McLaughlin said. "Any of my nonprofit clients would be thrilled to get a grant for half of what these people wasted."

James E. Post, a professor at Boston University's School of Management, said the Globe story showed the potential for what amounts to double-dipping by some foundation officials.

First, he said, wealthy individuals enjoy the significant tax breaks that flow from setting up a foundation. Then they or their successors make free use of the foundation assets to pay for high salaries and perks.

"It's not just tax avoidance; it's also the ability to feather your nest twice by paying yourself a big salary, or your family big salaries, or your colleagues big salaries," Post said. "If you're going to take public benefits extended through the tax system, you have to administer them in a way that the public gets its intended benefits."

A variety of measures at the federal, state, and foundation levels are needed to prevent the abuses, Post said. These include more funding for the IRS to significantly increase foundation audits; a recognition by state attorneys general that abuses in the foundation world are greater than they may realize; and the willingness of foundations to police themselves in an organized way.

Paul S. Grogan, president of the Boston Foundation, which awarded $48 million to nonprofit organizations last year, agreed that foundations have a responsibility to protect the public interest in the proper charitable use of their funds.

"It's a poorly kept secret in this country that, particularly among smaller private family foundations, there's a ton of abuse out there," Grogan said. "These are extraordinary privileges that our society has essentially conferred in order to prompt charitable giving, and these kinds of abuses besmirch that whole enterprise."

Beth Healy, Francie Latour and Walter V. Robinson of the Globe staff contributed to this story.

boston.com

THIS STORY HAS BEEN FORMATTED FOR EASY PRINTING

Legislation eyed to fight abuses at foundations

The Boston Globe

By Michael Rezendes
and Sacha Pfeiffer, Globe Staff, 3/1/2004

WASHINGTON – Citing an array of financial abuses at charitable foundations, federal officials and the Massachusetts attorney general's office plan to push new legislation and tougher regulations designed to curtail excessive salaries, lavish spending, and conflicts of interest by some foundation directors.

US Senator Charles E. Grassley, an Iowa Republican and chairman of the Senate Finance Committee, called the improprieties at foundations detailed in a recent Globe series "wrong and outrageous," and said new laws and more stringent rules are needed to ensure that the billions of dollars in foundation assets are used for charitable purposes and not to enrich insiders.

"We all expect them to operate transparently and not abuse money," Grassley said, in an interview with the Globe. "To me, it's Midwestern common sense."

Grassley's committee oversees the Internal Revenue Service, the agency that regulates foundations. He said he is considering legislation that would boost the IRS budget for auditing foundations, increase penalties against foundation directors who fail to disclose financial information, and tighten conflict-of-interest restrictions on directors who channel foundation business to their own companies.

Meanwhile, aides to Attorney General Thomas F. Reilly have drafted state legislation that would give Reilly's office clearer authority to remove board members at foundations or charities where abuses occur, and to dissolve those organizations if necessary.

Assistant Attorney General Jamie Katz, who oversees Reilly's public charities division, said new legislation is needed because financial abuses at foundations and public charities "are growing, not abating" and because public confidence in these institutions must be restored.

"We still believe most charitable organizations are run correctly. There is a minority where there are problems," Katz said. "But the problem from our perspective is the magnitude of that minority is growing and the amount of funds at stake is not minuscule."

There are more than 60,000 active foundations in the country today, according to foundation officials, with total assets of more than $400 billion.

Foundations are typically established by wealthy individuals who are granted tax breaks with the understanding that the assets of the foundations will be used for charitable purposes.

Both Grassley and Katz, in separate interviews with the Globe, compared the financial abuses in the foundation world to the Enron and WorldCom scandals in the corporate world that led to the Sarbanes-Oxley Act, the corporate accountability statute approved two years ago.

"The core model clearly is Sarbanes-Oxley, but we've tried to customize it both for the world of charities and for Massachusetts," Katz said of the attorney general's draft legislation, which is circulating among directors and officers at state charities and foundations.

Like Grassley, Katz said the push for new restrictions was spurred in part by the recent investigation by the Globe Spotlight Team that detailed numerous financial abuses at charitable foundations. The abuses included excessive salaries paid to foundation board members, many of whom work a few hours a week to approve a handful of grants to public charities; expensive perks for foundation directors, including private jets and luxury cars; and board members who direct legal and investment management contracts to their own companies.

In one case reported by the Globe, Paul C. Cabot Jr. of Needham boosted his salary at a family foundation to $1.3 million to cover the expense of a daughter's $200,000 wedding. In another instance, the Globe reported that the Arthur S. DeMoss Foundation, in Florida, spent $36 million to buy a 12-seat jet. Reilly's office has said it is reviewing Cabot's role as managing trustee of the Paul and Virginia Cabot Charitable Trust.

To pay for reforms in the foundation world, Grassley said his committee will consider amending the pending Charity Aid Recovery and Empowerment Act, or CARE, to earmark IRS funds for more audits of private foundations, and to strengthen penalties for failing to file complete and timely tax returns.

In recent years, the IRS has audited only about 100 foundations a year, in part, the agency has said, because it lacks funding. Approximately $500 million generated each year by an excise tax on foundation income -- a tax originally envisioned to fund IRS oversight of the sector -- goes to the US Treasury. A finance committee staff member said Grassley may call for setting aside $200 million of the excise tax revenue for foundation oversight, with perhaps $25 million going to state authorities that oversee foundations and charities on a local level.

Katz, describing the proposed state legislation, which has yet to be filed, noted that several of its provisions simply spell out powers already claimed by the attorney general, such as the power to sue to close a charity or foundation that is not acting in the public interest. But Katz said the legislation will make it easier for the attorney general to persuade a judge to allow him to take that action. He also said approval of the legislation would serve as a wake-up call to foundations and charities, prompting many to rein in excesses on their own.

The benefit of aggressive enforcement at the state level was underscored last week when three directors of the Grand Marnier Foundation of Paramus, N.J., resigned and paid $250,000 each to settle a lawsuit filed by Attorney General Eliot Spitzer of New York that accused them of enriching themselves at the foundation's expense. The assets of the foundation, which was founded by the former importer of Grand Marnier orange liqueur and Absolut vodka, dropped from $11.3 million in 1990 to $6.7 million in 2001, in part because of excessive salaries paid to the directors, according to Spitzer's office.

The need for increased self-policing was also a central theme at a conference in Boston last week on accountability among foundations and public charities. At the conference, the head of a leading organization representing foundations announced the details of a two-year initiative to improve ethics and governance standards in the foundation world and to work with state and federal regulators to stop abuses.

Dorothy S. Ridings, president of the Council on Foundations, a Washington, D.C., association of 2,000 grant-making organizations, said at the conference that "the government's oversight and enforcement capacity . . . have lagged far behind the astronomical growth our sector experienced in the 1990s." As a consequence, she said, abuses have resulted, and "grant-making foundations face the threat of eroding public trust and, for the first time in 35 years, stricter government regulation."

Calling IRS enforcement activity "woefully scarce," Ridings said her organization will focus on raising ethical awareness among foundation professionals and will continue to advocate for increased funding for IRS oversight of the sector.

Roy A. Hammer, a Boston attorney who specializes in trusts and estates, echoed the importance of increasing government funding for the oversight of foundations.

But Hammer, a conference panelist, said that enforcement of existing laws should be sufficient, and cautioned that "adding new laws that will substantially burden existing charities is not the way to deal with the wayward few."

APPENDIX B

The Boston Globe

FOUNDATION CHIEF AGREES TO REPAY OVER $4M

Author(s): Walter V. Robinson and Michael Rezendes, Globe Staff **Date:** December 16, 2004
Page: A1 **Section:** Metro/Region

In a rare public embarrassment for one of New England's oldest families, Paul C. Cabot Jr. of Needham has agreed to pay back more than $4 million to a family charitable foundation that he drained over several years to support a lifestyle that included a palatial family compound in Boca Grande, Fla., and a lavish wedding for one of his daughters.

The agreement with the office of Attorney General Thomas F. Reilly, which was announced yesterday, included a release of documents showing that Cabot used the foundation's millions, which are supposed to be donated to charity, to make mortgage payments on the Florida property and his home in Needham, to pay bills from yacht and golf clubs, and even to purchase guns. Cabot has agreed to make part of the restitution by selling both the Florida and Needham homes.

The sanctions are the most severe ever levied against a charitable foundation in Massachusetts. The attorney general plans to follow them with proposed legislation tightening regulation of public charities and toughening penalties for those who abuse the rules.

Jamie W. Katz, the chief of the attorney general's Public Charities Division, said in an interview that it was "unconscionable" that Cabot took so much money $7.5 million over nine years from a trust that his father left under his stewardship to benefit worthy charities.

Katz's office launched its investigation last year after the Globe Spotlight Team, as part of a series on abuses at charitable foundations, reported that Cabot paid himself salaries that exceeded $1 million a year from 2000 on. He took a raise to $1.4 million in 2001, he told the Globe in an October 2003 interview, because he needed an additional $200,000 to pay for his daughter's wedding.

In September 2003, a month before the Spotlight report, the charitable trust's assets had fallen to $3.8 million, from a high of $14 million in the mid-1990s.

Bruce Hopkins, a Kansas City attorney who is a specialist in foundation law, said the multimillion-dollar settlement is unusual. "That's a large number where you're having the individuals sell property, particularly a personal residence," Hopkins said. "It strikes me that the attorney general struck a pretty hard bargain. It's quite an achievement on the part of the Commonwealth."

Hopkins also said that, in addition to the settlement with Reilly's office, Cabot could face sanctions by the IRS, which has the authority to tax excessive compensation and self-dealing. "I hope he doesn't think that just because he's ponied up to the attorney general he's through, because that may not be the case," Hopkins said.

Reilly's office has also moved against another foundation examined in the Globe series. In October, the attorney general filed a formal demand in Suffolk Superior Court requiring that officers of the Copeland Family Foundation of Milton turn over extensive financial records. The Globe reported in January that the trustees had boosted their pay dramatically and awarded themselves generous pension plans starting in 2002, even as the foundation's assets plummeted by 32 percent.

But Katz said his office had found no violations of the law by two other foundations that, the Globe reported, paid their trustees extraordinarily high compensation. They are the Amelia Peabody Foundation of Wellesley and the V. Kann Rasmussen Foundation of Boston.

Margaret N. St. Clair and Bayard D. Waring, co-managing trustees of the Amelia Peabody Foundation, issued a statement last night saying, "We are pleased that the Attorney General's division of public charities has concluded that there are no issues to pursue concerning the operation of the Amelia Peabody Foundation."

Several other foundations, including the Mabel Louise Riley Foundation, have adopted conflict-of-interest guidelines in recent months, according to Katz. The Globe reported that the Riley Foundation in 2002 gave a $250,000 grant to the Massachusetts Golf Association. Robert W. Holmes Jr., a foundation trustee, was the legal counsel to the golf association at the time.

As a result of his office's review, Katz said, Reilly will file legislation next month designed to improve governance by the state's 22,000 public charities, which include nearly 5,000 charitable foundations. The legislation would require more diligence by trustees, give the attorney general greater authority to levy penalties, and require third-party research to ensure that compensation of officers and trustees is within reasonable boundaries.

The Globe investigation found that trustees at the vast majority of charitable foundations receive little or no compensation. But, using a nationwide database built from foundation tax returns, the Globe found hundreds of foundations where trustees took fees of tens of thousands and sometimes hundreds of thousands of dollars a year for little or no work.

Cabot was at the top of the list. In 2001, for example, he paid himself $1.4 million while authorizing just $464,000 in charitable grants by the foundation. He paid himself $1.3 million in the fiscal year ending January 31, 2003, and, Katz said, another $1.16 million from February through Sept. 2003.

To make restitution, Cabot has agreed to sell the two-house compound on the Gulf of Mexico and his home in Needham, and return his half of the proceeds to the Paul & Virginia Cabot Charitable Trust. The Florida compound is on the market for $3.2 million.

The residence on South Street in Needham 6,400 square feet with six bedrooms and four bathrooms is listed for sale at $2.5 million. The mortgages on the two properties, which Paul Cabot jointly owns with his wife, appear to be about $1.5 million. If they sold for the asking price $5.7 million for both that would mean that Paul Cabot's share might approach $2 million.

In addition, Cabot has agreed to take steps to turn over to the charitable trust another $2.47 million in two private family trusts of which he is the beneficiary.

The sanctions were agreed to by Cabot, his wife, Jennifer, and Cabot's two sisters who were trustees of the foundation.

Jennifer Cabot had no formal role in the charitable trust. Nonetheless, she reached a separate agreement with Reilly's office to return $555,000 to the foundation. In a series of interviews with the Spotlight Team, Paul Cabot said his wife's $10,000 monthly allowance was among the reasons he felt compelled to take such a large salary.

The probe by Katz's office suggested that Cabot treated the foundation account as his own, writing checks from it to pay for such things as his credit card bills, his income tax payments, artwork he purchased, and the mortgages on the two homes. In the foundation tax returns, however, he included those charges as part of his compensation.

All told, Katz said, the restitution is expected to be about $4.5 million. "Given the magnitude of the recovery, and the willingness of family members to enter into it, we felt that this was the most appropriate action to take," Katz said.

Cabot voluntarily relinquished his role in the charitable trust soon after the Globe report, according to Katz. Under the agreement, Cabot is barred for life from any role in any Massachusetts charity.

Cabot's two sisters, Elizabeth C. Minot of Dover and Virginia C. Wood of Groton, were his cotrustees. As part of the agreement, they will also step aside. A year ago, Cabot said in an interview that his sisters never saw the foundation's tax returns and had no inkling about his compensation.

Katz said he reached the same conclusion. The sisters, he said, "were quite appalled to learn how the assets were being used, and were very eager to have those assets restored." Under the law, trustees can be held accountable even if they are unaware of violations.

A statement released last night by Martin F. Murphy and William L. Patton, the lawyers, respectively, for Jennifer and Paul Cabot, read: "We cooperated fully with the Public Charities Division since it began its investigation last year. We are pleased that this matter has been resolved."

Paul Cabot, 74, could not be reached for comment. A woman who answered the phone at his Needham home last night said he had been hospitalized.

Separately, Reilly's office filed court documents ordering the Copeland Family Foundation, the South Shore's most prominent charitable foundation, to hand over four years' worth of financial records, as well as the personal tax returns for all five of its trustees. Reilly's office said that compensation for trustees of the $28 million foundation shot up by 383 percent in just one year.

The Globe had reported in January on an eightfold jump in compensation for the foundation's president, Martha Verdone. Verdone received her windfall shortly after she replaced her divided board of directors with a new board that included her 91-year-old mother and two longtime associates who had no foundation experience.

Katz said the investigation would also look at why Verdone and another trustee were drawing two full-time salaries, one from the foundation and the other from the holding company that handles assets left behind by the foundation's benefactor, the late Charles L. Copeland. "We have concerns whether two full-time jobs are being performed, and whether the compensation being collected is appropriate," Katz said.

Neither Verdone nor her attorney, J. David Moran, could be reached for comment.

The Globe series reported on abuses at private foundations throughout the country and, subsequently, the IRS and the Council on Foundations, a membership organization of charitable foundations, initiated several reforms.

Perform a new search