

**THE COLLAPSE  
OF THE  
FOUNDATION FOR NEW ERA PHILANTHROPY**

Staff Report to the General Assembly  
Including a Narrative of  
the Foundation's Operations  
and an Analysis of  
the Relevant Regulatory Statutes

General Assembly of the Commonwealth of Pennsylvania  
**JOINT STATE GOVERNMENT COMMISSION**  
November 1995

**JOINT STATE GOVERNMENT COMMISSION**  
**ROOM 108 - FINANCE BUILDING**  
**HARRISBURG PA 17120**

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The Joint State Government Commission was created by act of July 1, 1937 (P.L.2460, No.459) as amended, as a continuing agency for the development of facts and recommendations on all phases of government for the use of the General Assembly.

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# JOINT STATE GOVERNMENT COMMISSION, 1995

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**GENERAL ASSEMBLY OF THE COMMONWEALTH OF PENNSYLVANIA  
JOINT STATE GOVERNMENT COMMISSION  
ROOM 108 - FINANCE BUILDING  
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**TO THE MEMBERS OF THE GENERAL ASSEMBLY:**

The Joint State Government Commission is pleased to present this report detailing the known facts concerning the May 1995 bankruptcy of a charitable advisory and fund raising entity known as the Foundation for New Era Philanthropy.

The collapse of the foundation occasioned millions of dollars of loss to eleemosynary institutions serving citizens, students and the academic community. This event raised many questions with members of the General Assembly as to whether Pennsylvania statutory law is adequate to prevent a recurrence.

This Commission was asked to examine the statutory law and present its findings to the General Assembly. Herewith is that staff report.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Roger A. Madigan".

Roger A. Madigan  
Chairman



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## **SUMMARY**

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1. The Foundation for New Era Philanthropy (the foundation) of Radnor, Pennsylvania, incorporated as a domestic nonprofit corporation in 1989, yet failed to register with the Department of State as a charitable organization until 1993.
2. The foundation was never audited properly as statutorily required.
3. The department's Bureau of Charitable Organizations (the department)<sup>1</sup> waived the requirement for the foundation's audit by an independent public accountant upon its tardy, initial registration. The department exercised its discretion to accept a financial statement in lieu of the independent audit.
4. The department initially rejected the foundation's renewal registration statement for incomplete financial data and then accepted a submission

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<sup>1</sup>The department refers to the Department of State or the Bureau of Charitable Organizations of the Department of State. Some of the powers and duties of the Solicitation of Funds for Charitable Purposes Act, act of December 19, 1990 (P.L.1200, No.202), §§ 1-24; 10 P.S. §§ 162.1-.24, are delegated to the bureau. Because the department has responsibility accorded in the act, future references will not distinguish between the department and the bureau unless such a distinction is necessary.

notwithstanding the foundation's continued noncompliance with the independent audit requirement.

5. The Commonwealth alleges that the foundation and its president claimed that contributions from anonymous donors would be matched with funds placed by nonprofit corporations into the foundation's brokerage account for a fixed period of time so that interest derived therefrom would fund administration of the program and the nonprofit corporations' deposits would be doubled and returned at the conclusion of that period. The foundation's president reportedly admitted to the foundation's employees that there were no anonymous donors, which would suggest that the "matching contributions" were funds from subsequent depositors.
6. There was inadequate regulatory follow-through by the Office of Attorney General and the department. Notwithstanding the statutory requirement, the department is inadequately staffed to examine each registration statement and supporting documents filed by a charitable organization to ensure that registration requirements are satisfied.
7. Documentation proving the legitimacy of the foundation was either unobtained or inadequately scrutinized by creditors. The foundation relied upon its favorable reputation and demonstrated legitimacy by ostensibly performing as promised (until May 1995) to avoid disclosing

documentation which is otherwise routinely sought and obtained by potential creditors. Documentation that was disclosed was inaccurate or otherwise insufficient.

8. Although influential decision makers may have acted in good faith, they did not always exercise reasonable inquiry, skill and diligence of an ordinarily prudent person. Some boards of directors may have simply breached the standard of care owed to their nonprofit corporations. Other boards of directors may have been more careful yet still allowed their nonprofit corporations to be victimized because their legal counsel may not have exercised the due diligence reasonably required for offering legal advice.
9. The Joint State Government Commission concludes that the Solicitation of Funds for Charitable Purposes Act<sup>2</sup> is comprehensive legislation, adequately addressing concerns raised by the example of the foundation's conduct. Execution of this act was, however, inadequate to fully protect the citizens of this Commonwealth. Even if execution of the act is flawless, citizens who fail to exercise reasonable inquiry, skill and diligence may not be protected by this legislation.

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<sup>2</sup>Act of December 19, 1990 (P.L.1200, No.202), §§ 1-24; 10 P.S. §§ 162.1-.24.



## **INTRODUCTION**

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The Foundation for New Era Philanthropy (the foundation) was incorporated in 1989 as a domestic nonprofit corporation to improve (via consultation) administration of programs conducted by other nonprofit corporations. The foundation also provided funding to nonprofit organizations through monetary transactions<sup>3</sup> wherein matching funds were purportedly provided by anonymous donors.

During the spring of 1995 the foundation collapsed in newsworthy fashion. The foundation solicited money from charitable organizations and identified donors promising to return that amount of money plus matching funds to be contributed by anonymous donors. It has been reported and seems to be evident that there were no anonymous donors. The collapse occurred when the foundation petitioned for bankruptcy protection. Preceding and succeeding the petition for bankruptcy, civil actions were filed against the foundation by creditors and regulators.

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<sup>3</sup>These transactions amounted to loans whereby lenders would receive a grant from the foundation in lieu of interest. Interest generated from the loans was purportedly retained by the foundation; therefore, lenders may have regarded this transaction to be a grant conditional upon an interest free loan.

This report was prepared at the request of several members of the General Assembly to help determine whether new laws or administrative procedures regarding charitable organizations are necessary. The foundation's alleged practices are evaluated in conjunction with the relevant aspects of Pennsylvania law insofar as it relates to the Solicitation of Funds for Charitable Purposes Act. There may or may not be violations of federal law. The United States Department of Justice is also investigating the practices of this foundation. Since the exclusive scope of this inquiry is Pennsylvania law regarding charitable organizations, this analysis is limited to laws of the Commonwealth notwithstanding any possibly concurrent United States jurisdiction.<sup>4</sup>

It should be understood that this analysis is undertaken with material facts at issue. The most reliable findings of fact, because they are legally determinative, will come with the conclusion of litigation. In the meantime, this analysis will rely upon the more plausible of the alleged facts along with

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<sup>4</sup>Indeed, the Securities and Exchange Commission (SEC) has already filed a civil action against the foundation and its president, Securities and Exchange Comm'n v. Bennett, Civil Action No. 95-CV-3005 (E.D. Pa. filed May 18, 1995), alleging violations of 15 U.S.C. §§ 77e(a)(c) (relating to sale or delivery after sale of unregistered securities and necessity of filing registration statement), 77q(a)(relating to use of interstate commerce for purpose of fraud or deceit), 78j(b) (relating to manipulative and deceptive devices) and 17 C.F.R. § 240.10b-5 (relating to employment of manipulative and deceptive devices).

admissions of fact by the foundation.<sup>5</sup> Likewise, the efficacy of current Pennsylvania law can be determined only with the conclusion of litigation. This analysis is limited to discussing why current law may or may not be sufficient to redress any future similar conduct and practices by other foundations and determining whether new laws or administrative procedures regarding charitable organizations are necessary or recommended. This Commission preliminarily evaluated the foundation's practices. The evaluation is necessarily preliminary due primarily to the pending liquidation of the foundation and the ongoing criminal investigation by the United States Department of Justice.

In August 1995, the Joint State Government Commission requested that the department provide all public records relating to the foundation. The Commission received the Secretary of the Commonwealth's cease and desist order (May 17, 1995); the foundation's request for an extension until September 15, 1995, to renew its registration; the registration and return as well as the amended registration and amended return with an accompanying letter (June 29, 1994) from the foundation's certified public accountants identifying what was amended; and financial statements for the year ended

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<sup>5</sup>Extensive citations throughout this document identify the sources of the related information. Because of ongoing criminal investigation and civil litigation the sources of information were limited to commercial publications, filings relating to litigation, public records and interviews.

December 31, 1994, with an accompanying letter (May 20, 1993 [sic]) from the accountants addressed to the foundation's board of directors identifying the accompanying balance sheet as a review rather than an audit.

The facts relating to this financial collapse are somewhat confused because records appear inaccurate and incomplete. Moreover, outcome of the several civil actions remains unknown. Many have characterized the foundation's operation as a Ponzi<sup>6</sup> scheme. A bare Ponzi scheme produces no true profits from true investments because there are no true investments. Purported profits from misrepresented or nonexistent investments are actually funds from a recent wave of investors paying off a preceding wave of investors. Obviously, Ponzi schemes can continue only so long as each succeeding wave of investors produces funds sufficient to pay off the preceding wave.

Bankruptcy law and practice is not a focus of this document, but in simplistic terms it is a legal resolution for debtors who cannot timely satisfy all creditors. Bankruptcy is an orderly process where a debtor's assets are marshaled and creditors are ranked in priority to be paid. The ranking of creditors is an attempt to be relatively fair to all creditors. The first class of

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<sup>6</sup>Variations of Ponzi schemes are probably as old as capitalism, but the name is taken from a man who similarly defrauded investors in Massachusetts 65 years ago. See generally Donald H. Dunn, Ponzi!: The Boston Swindler (New York: McGraw-Hill Book Co., 1975).



creditors are those who have secured their loans. The second class of creditors have not secured their loans. A secured loan is one whereby the creditor promises to lend or lends in exchange for a return promise to repay or to surrender specified collateral should the debtor fail to repay. An unsecured loan is one whereby the creditor promises to lend or lends for return promise to repay. Typically, the result of bankruptcy is that creditors who have secured their loans receive their collateral, and creditors who have failed to secure their loans share the remainder of the assets.

Of course, the waves of investors who were paid off before a Ponzi scheme collapses recover their investment, often with an extraordinary profit. The wave of investors at the time of the collapse are unsuccessful because there is no succeeding wave of investors or the wave of investors is insufficient to pay them off. The bankruptcy proceeding will determine who are legitimate creditors and the actual amount owed them. When the debtor's assets are marshaled, some investors may have to return the funds received from the debtor because the funds were fraudulently conveyed or were conveyed when the debtor was legally considered to have been insolvent.



## **NARRATIVE OF THE FOUNDATION'S OPERATIONS**

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New Era Philanthropy was founded by John Bennett and operated in southeastern Pennsylvania perhaps ten years before it incorporated. Bennett was a consultant to foundations and advised the Bell Telephone Co. of Pennsylvania. In 1987, Bell Telephone endowed the Bell Institute for Nonprofit Excellence to train nonprofit corporations in business and management. The institute was directed from the offices of New Era Philanthropy. The institute conducted three-day sessions which required the attendance of at least three individuals including at least one board member of each nonprofit corporation admitted to the training session. The attendees were obliged to submit a progress report and completed planning strategy following the seminar; the attending staffs commonly requested further assistance and training for their boards of directors.<sup>7</sup>

New Era Philanthropy may have operated legitimately until it intended to solicit donors yet neglected to register as a charitable

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<sup>7</sup>Susan Calhoun, "Ring Leader," Foundation News & Commentary, May/June 1989, 50-52.

organization. The foundation gave grants at least as early as the year (1989) in which it incorporated.

On October 20, 1989, The Foundation for New Era Philanthropy

incorporated under the Nonprofit Corporation Law of the Commonwealth of Pennsylvania for . . . : [a]ny lawful purpose permitted under the Nonprofit Corporation Law, 15 Pa. S. §7316.<sup>8</sup> [sic] Without limiting the generality of the foregoing, the corporation shall engage in providing, free of charge, managerial and consulting services for nonprofit organizations exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code to improve the administration of their charitable, educational, religious, etc. programs.

The foundation was incorporated to exist perpetually and organized upon a nonstock basis with no members. On November 13, 1990, the foundation amended its articles of incorporation as a domestic nonprofit corporation. Evidently, the amendment was to diminish the corporation's purposes because the amendment omits the general purpose of "any lawful purpose permitted under the Nonprofit Corporation Law" and restates verbatim part of the original purpose: "The corporation shall engage in providing, free of charge, managerial and consulting services for nonprofit organizations exempt from federal income tax under Section 501(c)(3) of the

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<sup>8</sup>This quotation is excerpted from the foundation's Articles of Incorporation filed with the Department of State. This citation is erroneous. First, the citation should have referenced Pennsylvania Consolidated Statutes (Pa.C.S.) rather than Pennsylvania Statutes (Pa. S.). Second, 15 Pa.C.S. § 7316 was renumbered as § 5306 by the act of December 21, 1988 (P.L.1444, No.77), § 103. The effective date of the renumbering was October 1, 1989, *id.* at § 304, 19 days prior to the foundation filing its articles.

Internal Revenue Code to improve the administration of their charitable, educational, religious, etc. programs."<sup>9</sup>

The foundation failed and refused to register as statutorily required as a charitable organization<sup>10</sup> until Pennsylvania's Office of the Attorney General demanded that it do so in mid 1993.<sup>11</sup> On May 11, 1995, Prudential Securities, Inc. sued the foundation in federal court to recover funds allegedly owed pursuant to a loan agreement.<sup>12</sup> Shortly thereafter, the foundation voluntarily petitioned for bankruptcy protection in United States

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<sup>9</sup>In the foundation's review prepared by John P. McCarthy and Co., certified public accountants, dated May 1993 but probably performed in May 1994 (see infra, notes 19, 22), the nature of organization is summarized as follows: "The Foundation . . . works with other non-profit organizations to assist them in expanding their individual philanthropic capabilities. This is accomplished through evaluating, developing and providing programs on behalf of grant making institutions and individuals free of charge. Direct financial assistance may also be given. . . ." Notes to financial statements, Note A at 5 (May 20, 1993)[sic].

<sup>10</sup>Some charitable organizations are exempt from registration requirements of the Solicitation of Funds for Charitable Purposes Act. Act of December 19, 1990 (P.L.1200, No.202), § 6; 10 P.S. § 162.6. For instance, charitable organizations receiving \$25,000 or less annually which don't compensate a solicitor are exempt from registration requirements, id. at § 6(a)(8); 10 P.S. § 162.6(a)(8); however, the foundation was never exempt from registration under this act. Although this act did not become effective until February 19, 1991, id. at § 25, the act it repealed, the Charitable Organization Reform Act, act of April 30, 1986 (P.L.107, No.36); 10 P.S. §§ 161.1-.19, was in effect at the time of the foundation's incorporation and required the foundation to register prior to any solicitation, id. at § 6(a); 10 P.S. § 161.6(a).

<sup>11</sup>Letter from the Office of Attorney General to John G. Bennett, president of the foundation, of July 8, 1993, at 1. The registration was submitted in September 1993, and the foundation was fined \$1,000 for having failed to previously register. Personal interview with John T. Henderson, Assistant Counsel of the Department of State (Sept. 22, 1995).

<sup>12</sup>"New Era Scandal: A Chronology of Legal Actions Taken Thus Far," Chronicle of Philanthropy, VII, no. 16 (1 June 1995): 27.

Bankruptcy Court.<sup>13</sup> Almost immediately thereafter, the Commonwealth sued the foundation alleging multiple violations of law relating to charitable solicitations, unfair trade practices and non-profit corporations. Perhaps the rapidity of the filing of legal petitions should be emphasized. Prudential Securities filed its civil action on Thursday, May 11. The foundation, through John G. Bennett Jr. and its attorney, Neal D. Colton, signed its voluntary

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<sup>13</sup>In re Foundation for New Era Philanthropy, No. 95-13729 (Bankr. E.D. Pa. filed May 15, 1995). The voluntary petition disclosed that the debtor estimated that funds would be available for distribution to unsecured creditors; therefore, the foundation, characterizing itself as a corporation not publicly held whose business nature was charitable, filed its petition under chapter 11 (relating to reorganization) of the bankruptcy code. The debtor estimated assets totaling \$80 million and liabilities totaling \$551 million. Of those liabilities, the debtor estimated one disputed secured claim totaling \$45 million and approximately 300 disputed unsecured claims totaling \$506,613,000.

Aside from Prudential Securities, Inc., the debtor disclosed other known creditors in its petition. Among others, the following are a representative sample: Bell Atlantic, Lehigh Valley; Lizell's Office Furniture, Montgomeryville; Main Line Travel Services, Bala Cynwyd; Radnor Center Associates, Philadelphia; and Your Gourmet Kitchen, Wayne. The foregoing had outstanding invoices as of May 13, 1995. Other known creditors disclosed by the debtor are probably participants in the matching funds program whose contributions have not yet been matched. Among others, the following are a representative sample: The Academy of Natural Sciences, Philadelphia; The Stewart Huston Charitable Trust, Coatesville; and The Huston Found., West Conshohocken. Among the known creditors disclosed by the debtor as non-profit participants in New Concepts, *infra*, at 28, the following is a representative sample: American Red Cross, Philadelphia; Biblical Theological Seminary, Hatfield; Christian Counseling & Educ. Found., Laverock; Ephrata Community Hosp. Found., Ephrata; Esperanza Health Ctr., Philadelphia; International Missions, Reading; Lititz Christian Sch., Lititz; Menno Haven, Inc., Chambersburg; National Museum of Am. Jewish History, Philadelphia; Presbyterian Children's Village, Rosemont; Salvation Army, Philadelphia; University of Pennsylvania, Philadelphia; White-Williams Scholars, Philadelphia; Beaver College, Glenside; The Christian Academy, Media; Drexel Univ., Philadelphia; The Free Library of Philadelphia, Philadelphia; Landis Homes Retirement Community, Lititz; Messiah College, Grantham; The Philadelphia Orchestra Ass'n., Philadelphia; Settlement Music Sch., Philadelphia; and WHYY, Inc., Philadelphia.

On May 19, 1995, the bankruptcy case was converted from chapter 11 to chapter 7 (relating to liquidation). By the filing deadline, claims against the foundation totaling \$355 million were processed, but the federal trustee asserts that the foundation has approximately \$31 million and owes approximately \$107 million to creditors. Casey Combs, "Claims Filed Against New Era Exceed \$725 Million," Philadelphia Inquirer, Sept. 27, 1995, p. 3(B), and "Correction," Patriot News, 28 September 1995, p. 2(A).

petition for bankruptcy on Sunday, May 14. The petition for bankruptcy was received by United States Bankruptcy Court the next day, Monday, May 15. The following day, Tuesday, May 16, the Commonwealth filed its action in Commonwealth Court.

The Commonwealth Court of Pennsylvania granted special ex parte relief to the Commonwealth on May 17, 1995.<sup>14</sup> Such relief<sup>15</sup> resulted in a freeze of all assets of the foundation, suspension of the registration of the foundation as a charitable organization and an order forbidding the foundation to solicit funds or property in the Commonwealth.<sup>16</sup>

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<sup>14</sup>The attorney general may bring action in the name of the Commonwealth to enjoin violations of the Solicitation of Funds for Charitable Purposes Act as well as seek other relief. Act of December 19, 1990 (P.L.1200, No.202), § 19(a); 10 P.S. § 162.19(a). Other relief may include appointment of a master, sequestration of assets, reimbursement of contributions, distribution of contributions, reimbursement of the Commonwealth's costs and assessment of civil penalty. *Id.*

<sup>15</sup>The Commonwealth was able to obtain such relief because voluntary petitions for bankruptcy protection do not operate as a stay "of the commencement . . . of an action . . . by a governmental unit to enforce such governmental unit's police or regulatory power;" nor do they operate as a stay "of the enforcement of a judgment . . . obtained in an action . . . by a governmental unit to enforce such governmental unit's police or regulatory power[.]" 11 U.S.C. § 362(b)(4)(5).

<sup>16</sup>The assets situate in this Commonwealth were ordered frozen by Pa. Commw. Ct. Commonwealth v. Foundation for New Era Philanthropy, No. 232 M.D. 1995 (Pa. Commw. Ct. filed May 16, 1995), Memorandum and Order (ordered May 17, 1995). The suspension of registration and cease and desist solicitation of funds and property order were ordered by Department of State. In the matter of Foundation for New Era Philanthropy, Order (May 17, 1995).

## FINANCIAL INFORMATION

The foundation, although incorporated in 1989, did not register with the department until September 1993. On September 29, 1993, John P. McCarthy and Co., certified public accountants, requested that the department's Bureau of Charitable Organizations (the bureau) waive the requirement for audited financial statements for calendar year 1992.<sup>17</sup> The department granted this waiver on October 6, 1993. The foundation's renewal registration and Internal Revenue Service (IRS) Return of Organization Exempt From Income Tax (the return) were received by the bureau in May 1994. Renewal registration was disapproved because the requisite financial data was incomplete.<sup>18</sup> A review from certified public

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<sup>17</sup>Letter from John P. McCarthy and Co. to the department of 9/29/93.

<sup>18</sup>Letter from the department to the foundation of 5/4/94.



accountants was submitted in May as well.<sup>19</sup> An amended registration and an amended return were received by the bureau on July 5, 1994. On May 1, 1995, the department received the foundation's request, dated April 28, 1995, for an extension of time until September 15, 1995, to file its registration for the immediately preceding fiscal year, 1994.<sup>20</sup> The reason<sup>21</sup> given by the foundation is that it was waiting for third party documents to complete its

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<sup>19</sup>It is impossible to discern from the documents the precise order of submissions. A letter accompanying the certified public accountants' review is addressed to the foundation's board of directors and dated May 20, 1993, although it is clear from the accompanying balance sheet and the text of the letter that the date should be 1994. The financial statement, the subject of the review, is dated as being received by the bureau on May 12, 1994, which precedes the letter to the foundation's board of directors by eight days (accepting as true that the letter should have been dated May 20, 1994, instead of 1993) which might indicate that the bureau received the review before the board of directors did. Registration Statement for Charitable Organization-Full Form BCO-100 for Preceding Fiscal Year End December 31, 1993 (the registration) is dated as being received by the bureau on May 2, 1994, and on May 12, 1994. (The registration is filed on the same form regardless whether it is an initial, renewal or volunteer registration. The foundation initially registered in 1993, so that the registration discussed herein is a renewal). The date stamped May 12 is circled. Pennsylvania Public Disclosure-Long Form BCO-23, part of the registration, is also stamped twice, May 2 and May 12, 1994, with neither date having been circled. Likewise, the return bears those two dates indicating receipt by the bureau, and neither is circled. Finally, a copy of the form (BCO-10R) addressed to the foundation disapproving the application bears a typewritten date, May 4, 1994. (This is the same document identified as a letter, supra note 18.) BCO-10R also bears a stamped date, May 6, 1994, and stamped date indicating receipt by the bureau on May 12, 1994. What may have occurred is that the bureau received the registration and the return from the foundation on May 2, 1994. On May 4, 1994, the bureau disapproved the registration for incomplete financial data and requested the requisite audited financial information. The foundation then submitted the certified public accountants' review rather than the mandatory independent audit, and the bureau received this on May 12, 1994, and erroneously approved the registration.

<sup>20</sup>A charitable organization must refile annually a registration statement, "within 135 days after the close of its fiscal year in which the charitable organization was engaged in solicitation activities." Act of December 19, 1990 (P.L.1200, No.202), § 5(a); 10 P.S. § 162.5(a). The last day of 1994 was the close of the foundation's fiscal year which made May 15 the 135th day after the close of its fiscal year.

<sup>21</sup>"For good cause shown, the department may extend the time for the annual filing of a registration statement or financial report for a period not to exceed 180 days during which time the previous registration remains in effect." Act of December 19, 1990 (P.L.1200, No.202), § 5(k); 10 P.S. § 162.5(k).

registration in accordance with the statutory requirement that charitable organizations which receive contributions in excess of \$100,000 be audited by an independent public accountant.<sup>22</sup> This audit is required for the financial report which must be filed with each registration.<sup>23</sup>

In its amended renewal registration for the preceding fiscal year ending the last day of 1993, the foundation reported soliciting contributions in the following additional names: Youth in Philanthropy, New Concepts in

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<sup>22</sup>Id. at § 5(f); 10 P.S. § 162.5(f). Notwithstanding this requirement, John P. McCarthy and Co., certified public accountants, "audited" the foundation's balance sheet for the year ending December 31, 1993. All information in the financial statements were representations of the management of the foundation. Actually, this audit was really a review which "consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly we do not express such an opinion." Letter from John P. McCarthy & Co. to the board of directors of the foundation (May 20, 1993). (The date must contain the incorrect year because the review could not cover the period through December when that was more than seven months away from the date of the letter. The letter should probably be dated May 20, 1994.)

One should remember that the foundation did not register with the department until 1993 and obtained a waiver to avoid submitting an audited financial statement for the year ending December 31, 1992. This review substituted for the required audited financial statement for the year ending December 31, 1993. The foundation obtained an extension to register its audited financial statement for the year ending December 31, 1994, and then quickly petitioned for bankruptcy protection. There apparently was never an audit in the foundation's existence which has been almost six years.

<sup>23</sup>Act of December 19, 1990 (P.L.1200, No.202), § 5(e); 10 P.S. § 162.5(e). Willful and knowing violations of the Solicitation of Funds for Charitable Purposes Act, act of December 19, 1990 (P.L.1200, No.202); 10 P.S. §§ 162.1-24, with intent to deceive or defraud any charity or individual is a misdemeanor of the first degree. Id. at § 18, 10 P.S. § 162.18. Any other violation of the act is misdemeanor of the third degree. Id.

Philanthropy Fund, Bell Institute and Templeton Institute.<sup>24</sup> The purpose for which the foundation was organized was "to work with other non profit organizations to help create, assist or manage their individual philanthropic interest and needs."<sup>25</sup> The foundation denied compensating any person or intending to compensate any person for conducting solicitations.<sup>26</sup>

The information contained in this subsection as well as the following one is unquestionably the most tedious of this report. The financial information was obtained from the department. This information is a public record available for review by anyone who wishes to obtain it. Since it is the only financial information filed with the department in the foundation's nearly six year existence (after incorporation), it is related in some detail. Aside from relating to the reader the financial figures reported to the department, the following will give the reader an opportunity to discover how useful it is for someone to obtain these or similar public records.

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<sup>24</sup>Department of State (Bureau of Charitable Organizations), Registration Statement for Charitable Organization-Full Form BCO-100 for Preceding Fiscal Year End December 31, 1993 (amended) (June 30, 1994), item 2 [hereinafter Registration]. On form 990, Return of Organization Exempt From Income Tax (amended) (1993) (June 30, 1994), [hereinafter Return] attachment to part VI, line 80, the foundation disclosed that it is related through common membership, governing bodies, trustees, officers, etc. to these organizations: The Alan Ameche Memorial Foundation, exempt; The Evelyn M. Bennett Memorial Foundation, exempt; and The Bennett Group International, Ltd.

"Professional fees totaling \$14,733 for services rendered on behalf of the Alan Ameche Memorial Foundation (a non-profit organization) were paid by the Foundation. The Alan Ameche Memorial Foundation and the Foundation have a common officer." Notes to financial statements, note F at 7, John P. McCarthy and Co. (May 20, 1993)[sic].

<sup>25</sup>Registration, item 4.

<sup>26</sup>Id., item 10.

For the fiscal year concluding on December 31, 1993, the foundation disclosed:

<u>Revenues</u>	
Gross (general) contributions <sup>27</sup>	\$41,242,571
Other (miscellaneous) income <sup>28</sup>	<u>35,943</u>
Total income <sup>29</sup>	\$41,278,514
 <u>Expenditures</u>	
Program services <sup>30</sup>	\$36,319,839
Administration <sup>31</sup>	<u>703,532</u>
Total expenditures <sup>32</sup>	\$37,023,371

The excess of revenues over expenditures for the year was represented to total \$4,255,143.<sup>33</sup> Adding \$322,102<sup>34</sup> from the fund balance at the beginning of the fiscal year, the foundation calculated its fund balance at the end of fiscal year 1993 as \$4,577,245.<sup>35</sup>

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<sup>27</sup>Pennsylvania Public Disclosure-Long Form BCO-23, line 6.

<sup>28</sup>Id., line 10.

<sup>29</sup>Id., line 11.

<sup>30</sup>Id., line 12.

<sup>31</sup>Id., line 14.

<sup>32</sup>Id., line 18.

<sup>33</sup>Id., line 19.

<sup>34</sup>Id., line 20.

<sup>35</sup>Id., line 22.

AMENDED<sup>36</sup> IRS FORM 990-RETURN OF ORGANIZATION EXEMPT  
FROM INCOME TAX

The foundation indicated on its return, a form open to public inspection, that its accounts were kept on an accrual basis.<sup>37</sup> For the fiscal year concluding on December 31, 1993, the return lists revenue and expenditures as follows:

<u>Revenues</u>	
Direct public support <sup>38</sup>	\$41,259,917
Interest on savings and temporary cash investments <sup>39</sup>	33,788
Dividends and interest on securities <sup>40</sup>	2,155
Loss on the sale of securities <sup>41</sup>	<u>(17,346)</u>
Total revenues <sup>42</sup>	\$41,278,514
 <u>Expenditures</u>	
Grants and allocation for program services <sup>43</sup>	\$34,563,600
Other salaries and wages <sup>44</sup>	119,354
Other employee benefits <sup>45</sup>	67,206
Payroll taxes <sup>46</sup>	11,211

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<sup>36</sup>See *infra* note 116.

<sup>37</sup>The return was prepared by Andrew Cunningham of John P. McCarthy & Co.

<sup>38</sup>Part I, line 1a.

<sup>39</sup>Part I, line 4.

<sup>40</sup>Part I, line 5.

<sup>41</sup>The foundation disclosed on its supplemental schedules to form 990 that it lost \$3,656 selling 8,000 shares of Tasty Baking, \$4,830 selling 14,388 shares of Serv. Master Ltd., \$1,702 selling 2,530 shares of Weyerhaeuser and \$9,910 selling 8,600 shares of Allied Signal for a loss of \$20,098 against a gain of \$2,752 selling 4,651 shares of Coca-Cola for a total loss of \$17,346 on sales of stock.

<sup>42</sup>Part I, line 12.

<sup>43</sup>Part II, line 22.

<sup>44</sup>Part II, line 26.

<sup>45</sup>Part II, line 28.

<sup>46</sup>Part II, line 29.

Accounting fees <sup>47</sup>	70,776
Legal fees <sup>48</sup>	66,264
Supplies <sup>49</sup>	25,874
Telephone <sup>50</sup>	24,166
Postage and shipping <sup>51</sup>	10,712
Occupancy <sup>52</sup>	78,644
Equipment rental and maintenance <sup>53</sup>	7,785
Printing and publications <sup>54</sup>	53,449
Travel <sup>55</sup>	502,198
Conferences <sup>56</sup>	84,368
Depreciation <sup>57</sup>	16,068
Other expenses <sup>58</sup>	<u>1,321,336</u>
Total functional expenses <sup>59</sup>	\$37,023,371

The foundation's statement of program service accomplishments was "to provide technical and financial support to non-profit organizations."<sup>60</sup>

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<sup>47</sup>Part II, line 31.

<sup>48</sup>Part II, line 32. The accounting fees were paid to John P. McCarthy and Co., the paid preparer of the return. Schedule A, Part II. This part requires disclosure of the compensation of the five highest paid persons for professional services. The compensation listed for John P. McCarthy and Co. is the lowest compensation among the five persons listed; therefore, the recipient of the legal fees was undisclosed. Dechert, Price & Rhoads was general counsel to the foundation when it collapsed in May 1995. Julie Stoiber, "Law Firms Associated with New Era Now a Target," Philadelphia Inquirer, 21 October 1995, p. 1(D). Tax work for the foundation in 1993 and 1994 was performed by Stradley, Ronon, Stevens & Young. Id. It is unknown how much if any either of these two firms received of the \$66,264 declared by the foundation as expenses for legal fees during 1993.

<sup>49</sup>Part II, line 33.

<sup>50</sup>Part II, line 34.

<sup>51</sup>Part II, line 35.

<sup>52</sup>Part II, line 36.

<sup>53</sup>Part II, line 37.

<sup>54</sup>Part II, line 38.

<sup>55</sup>Part II, line 39.

<sup>56</sup>Part II, line 40.

<sup>57</sup>Part II, line 42.

<sup>58</sup>Part II, line 43b and supplemental schedules. Of this amount \$1,169,673 was spent for faculty, consultants and technical advice.

<sup>59</sup>Part II, line 44.

<sup>60</sup>Part III, line a.

The foundation further declared:

Assets at the beginning of 1993 <sup>61</sup>	\$495,439
Assets at the end of 1993 <sup>62</sup>	4,609,066
Total liabilities at the beginning of 1993 <sup>63</sup>	173,337
Total liabilities at the end of 1993 <sup>64</sup>	31,821

This left the foundation with an unrestricted fund balance of \$322,102 at the beginning of 1993 and \$4,577,245 at the end of 1993.<sup>65</sup>

On its IRS filing, the foundation identified Mary Sinclair, vice president-program management, as its only officer, director, trustee or key employee who was compensated in 1993.<sup>66</sup> During the same year the five highest paid persons for professional services and their compensation were listed as:<sup>67</sup>

Laurel Communications	\$135,000
RWO Associates	200,004
Cotterall/McGillin Associates	84,522
J. Douglas Holladay	162,500
John P. McCarthy & Co.	70,776

The foundation stated that it had received donated services or the use of materials, equipment or facilities at no charge or at substantially less than fair

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<sup>61</sup>Part IV, line 59.

<sup>62</sup>Id. Included in this figure is an investment in nonmarketable equity securities. "This amount represents a minority interest in a closely held corporation. The investment is carried at its original cost of \$1,100,000 at December 31, 1993." Notes to financial statements, note E at 6, John P. McCarthy and Co. (May 20, 1993)[sic].

<sup>63</sup>Part IV, line 66.

<sup>64</sup>Id.

<sup>65</sup>Part IV, line 74.

<sup>66</sup>Part V. She was paid \$30,000 in 1993 according to the foundation's filing.

<sup>67</sup>Schedule A, Part II.

rental value.<sup>68</sup> It denied soliciting any contributions or gifts that were not tax deductible.<sup>69</sup> Under activities, the foundation stated that it had made grants for scholarships, fellowships, student loans, etc.<sup>70</sup>

The foundation explained how it had determined that individuals or organizations receiving grants or loans from it in furtherance of its charitable programs qualified to receive payments. The foundation's eligibility procedure as taken from Schedule A of its return stated:

Applicants should prepare a brief letter of inquiry, no more than two pages in length. Inquiry letter should include the following: a brief description of the organization[,] summary defining the need for grant consideration[,] amount of funding being requested[,] dates of any technical assistance or training received from the foundation[,] dates of any technical assistance or training received from the foundation such as an institute for non-profit excellence[.] Letters of inquiry from organizations which have participated in training will be acknowledged within 30 days. Grant application forms will only be given to eligible organizations. The grant review committee meets quarterly during the calendar year.

#### Exclusions

The Foundation for New Era Philanthropy will not award grants to: organizations that are not 501(c)(3)[;] organizations that discriminate on the basis of race, sex, age, or national origin[;] building projects[;] fraternal organizations[;] government agencies[;] labor organizations[;] political causes or interests[;] veteran's organizations[.]

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<sup>68</sup>Part VI, line 82a.

<sup>69</sup>Part VI, line 84a.

<sup>70</sup>Schedule A, Part III, line 3.



The foundation stated that it qualified for non-private foundation status because it normally receives a substantial part of its support from a governmental unit or from the general public.<sup>71</sup> The foundation's support schedule listed the following gifts, grants and contributions as received from 1989 through 1992:<sup>72</sup>

1989	\$306,201
1990	1,402,946
1991	2,616,847
1992	<u>8,641,170</u>
Total	\$12,967,164

For the same time period, the foundation listed the following as gross income from interest, dividends, amounts received from payments on securities loans, rents, royalties, and unrelated business taxable income from businesses acquired by the organization after June 30, 1975:<sup>73</sup>

1990	\$238
1991	647
1992	<u>1,449</u>
Total	\$2,334

Combining gifts with this gross income, the foundation's support schedule shows total revenues of \$12,969,498 during the period 1989 through 1992.<sup>74</sup> The corresponding distributions to participating nonprofit corporations during the same period were reported to the IRS as:

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<sup>71</sup>Schedule A, Part IV, line 11a.

<sup>72</sup>Id., line 15.

<sup>73</sup>Id., line 18.

<sup>74</sup>Id., line 24.

1989 <sup>75</sup>	\$124,908
1990 <sup>76</sup>	419,513
1991 <sup>77</sup>	1,307,769
1992 <sup>78</sup>	<u>7,120,905</u>
Total	\$8,973,095

The foundation was exempt from federal taxes under a statutory provision for foundations organized and operated exclusively for charitable purposes when no part of net earnings inure to the benefit of any private shareholder or individual, and the foundation's propaganda activities are insubstantial and apolitical.<sup>79</sup> This exemption per se establishes the foundation as a charitable organization in Pennsylvania.<sup>80</sup> The foundation represented that it intended to raise funds through "discrete, private communications with selected individuals."<sup>81</sup> Curiously, the foundation disclosed that the scope of its program services, seminars and consultation "to other non-profit organizations to assist them in maximizing their operation efficiency," was national yet claimed that the registration statement's query

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<sup>75</sup>Commonwealth v. Foundation for New Era Philanthropy, No. 232 M.D. 1995 at ¶ 11 (Pa. Commw. Ct. filed May 16, 1995).

<sup>76</sup>*Id.*, at ¶ 12.

<sup>77</sup>*Id.*, at ¶ 13.

<sup>78</sup>*Id.*, at ¶ 14.

<sup>79</sup>26 U.S.C. § 501(c)(3).

<sup>80</sup>Act of December 19, 1990 (P.L.1200, No.202), § 3; 10 P.S. § 162.3. Even aside from this exemption, "any person who is or holds himself out to be established for any charitable purpose or any person who in any manner employs a charitable appeal as the basis of any solicitation or an appeal which has a tendency to suggest there is a charitable purpose to any solicitation" is within the definition of a charitable organization. *Id.*

<sup>81</sup>Registration, item 17.

regarding the scope<sup>82</sup> of its fund raising activities was not applicable. The foundation denied that any other governmental agency authorized it to solicit contributions in any other jurisdiction.<sup>83</sup>

After reviewing the public records available from the department, an observant person might have noted that no audited financial statement was provided. He might have noticed that the registration was a renewal and wondered about past audited financial statements, which were also unavailable. He might have wondered why the line to disclose compensation of officers, directors, etc., is blank, yet other salaries and wages were only \$119,354 with other employee benefits totaling \$67,206 and payroll taxes \$11,211.<sup>84</sup> He might have been curious about the \$502,198 spent on travel or the \$1,169,673 spent on faculty, consultants and technical advice.<sup>85</sup> The foundation's response to the scope of its activities was inaccurate. An observer might wonder why the foundation had to borrow money for administrative expenses and question why some of the foundation's grant

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<sup>82</sup>Indeed, its scope admittedly became international during the year concluding on December 31, 1993. It began operating in United Kingdom of Great Britain and Northern Ireland "to conduct the same type of activities as those conducted in the United States." Notes to financial statements, note A at 5, prepared by John P. McCarthy and Co. (May 20, 1993)[sic].

This appears to make the response to question 20 of its renewal registration also incorrect because the response indicates that the scope of the organization's program services is only national.

<sup>83</sup>Registration, item 21.

<sup>84</sup>Part II, lines 25-29.

<sup>85</sup>Part II, lines 39 and 43b(B).

recipients were individuals.<sup>86</sup> The biggest concern should have been the absence of an audited financial statement.

### COMMONWEALTH V. FOUNDATION FOR NEW ERA PHILANTHROPY

The Commonwealth alleges that the foundation and its president, John G. Bennett Jr., "established a program called the New Concepts in Philanthropy Fund . . . by which nonprofits gave the Foundation . . . money based on the promise that the Foundation would double the contributing nonprofit's funds within a limited period of time in its . . . program."<sup>87</sup> The Commonwealth alleges that the foundation and its president claimed that contributions from anonymous donors would be matched with funds placed by nonprofit corporations into the foundation's brokerage account for a fixed period of time so that interest derived therefrom would fund administration of the program and the nonprofit corporations' deposits would be doubled and returned at the conclusion of that period.<sup>88</sup>

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<sup>86</sup>According to the foundation's schedule of grant recipients, these individuals, *inter alia*, received grants: Dr. Herbert W. Titus, \$5,000 on August 20, 1993; Kay MacDonald, \$500 on September 8, 1993; Larry Pons, \$25,000, \$6,000 and \$25,000 on March 18, October 4 and July 19, 1993; Mrs. Vivian Nimmo, \$5,000 on August 27, 1993; Ms. Peggy Norman, \$20,000 on October 13, 1993; and the Rev. H. Richard Cannon, \$1,000 on June 4, 1993.

<sup>87</sup>Commonwealth v. Foundation for New Era Philanthropy, No. 232 M.D. 1995 at ¶ 8 (Pa. Commw. Ct. filed May 16, 1995.).

<sup>88</sup>*Id.* at ¶ 10.

The Commonwealth allegedly spoke with the Bennett shortly after Prudential Securities filed its civil action at which time Bennett allegedly denied that the foundation had financial difficulties yet admitted to a cash shortfall.<sup>89</sup> Three days after this alleged conversation on May 15, 1995, the foundation voluntarily petitioned for bankruptcy protection.<sup>90</sup> The following day, May 16, 1995, the Commonwealth filed its action against the foundation.

The most relevant allegation made by the Commonwealth is that the foundation and its president defrauded nonprofit corporations via misrepresentations and omissions of material fact along with documentary material which "collectively operated as a devise [sic], scheme or artifice to defraud."<sup>91</sup> The Commonwealth alleges that the foundation and its president knew or should have known that it could not continue to match funds consistent with the representations soliciting funds.<sup>92</sup> If true, this could violate the Solicitation of Funds for Charitable Purposes Act because contributions may only be applied in a manner substantially consistent with the purpose expressed in the solicitation or registration statement.<sup>93</sup>

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<sup>89</sup>*Id.* at ¶¶ 29, 30.

<sup>90</sup>*See supra* note 13.

<sup>91</sup>*Commonwealth v. Foundation for New Era Philanthropy* at ¶¶ 40-43.

<sup>92</sup>*Commonwealth v. Foundation for New Era Philanthropy* at ¶ 47.

<sup>93</sup>Act of December 19, 1990 (P.L.1200, No.202), § 13(a); 10 P.S. § 162.13(a).

The Commonwealth cites other portions of the Solicitation of Funds for Charitable Purposes Act<sup>94</sup> as having been violated by the foundation and its president. The Commonwealth contends that the matching funds program was a misrepresentation of the foundation's nature or purpose or the purpose or beneficiary of a solicitation.<sup>95</sup> This contention may be well founded. The foundation estimated that 55 percent of the grants were donor directed with the foundation's board directing the remaining portion of the grants; however, the foundation admitted that it "is uncertain whether this information is correct."<sup>96</sup> Indeed, this uncertainty may be simply false<sup>97</sup> as the foundation's president has reportedly admitted to the foundation's employees that there were no anonymous donors.<sup>98</sup>

The Commonwealth contends that financial, registration and solicitation materials amounted to deceptive acts or practices which created

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<sup>94</sup>Act of December 19, 1990 (P.L.1200, No.202), § 13(d); 10 P.S. § 162.13(d).

<sup>95</sup>Commonwealth v. Foundation for New Era Philanthropy at ¶ 51(a).

<sup>96</sup>Debtor's Emergency Motion to file its List of Creditors under Seal and for an Order directing Impoundment at ¶ 8, In re Foundation for New Era Philanthropy, No. 95-13729 (Bankr. E.D. Pa. filed May 15, 1995).

<sup>97</sup>Vivian Piasecki, whom the foundation listed as a director, reportedly, see Moore et al. infra note 120, indicated that her title was honorary so that if other members of the foundation's board were also honorary directors, only the foundation's president would determine the recipients of the foundation's grants. Even this statement mischaracterizes the foundation's practices as reported because there were no anonymous grantors so that the foundation's president never had to determine who would receive a nonexistent benefactor's grant.

<sup>98</sup>Steve Stecklow, "Crumbling Pyramid," Wall Street Journal, 16 May 1995, p. 1(A).

a likelihood of confusion or misunderstanding,<sup>99</sup> and that the actual nature of the matching funds program were misrepresented.<sup>100</sup>

The Commonwealth contends that the foundation's and its president's administration of the matching fund program along with the representations made to nonprofit corporations participating in the program amounted to a breach of their fiduciary duty under this statute.<sup>101</sup> The statutorily deemed fiduciary capacity concerns solicitation, collection and expenditure of funds for charitable purposes.<sup>102</sup>

The Commonwealth contends that the foundation and its president failed to retain records apparently operating in violation of a requirement of the act.<sup>103</sup> "Each charitable organization required to register shall maintain records, books and reports for at least three years after the end of the period of registration to which they relate, which shall be available for inspection upon demand by the department and the Office of Attorney General."<sup>104</sup> The foundation "has not prepared any financial statements subsequent to an

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<sup>99</sup>Act of December 19, 1990 (P.L.1200, No.202), § 15(a); 10 P.S. § 162.15(a).

<sup>100</sup>Commonwealth v. Foundation for New Era Philanthropy at ¶ 51.

<sup>101</sup>Commonwealth v. Foundation for New Era Philanthropy at ¶¶ 53, 54.

<sup>102</sup>Act of December 19, 1990 (P.L.1200, No.202), § 21; 10 P.S. § 162.21.

<sup>103</sup>Id. at § 15(a)(1); 10 P.S. § 162.5(a)(1). These contentions are alleged in Commonwealth v. Foundation for New Era Philanthropy at ¶¶ 56, 57 along with the contention that the foundation and its president failed to submit a financial report audited by an independent public accountant which is required by § 5(f); 10 P.S. § 162.5(f).

<sup>104</sup>Act of December 19, 1990 (P.L.1200, No.202), § 5(o); 10 P.S. § 162.5(o).

audit for the year ended December 31, 1993. The [d]ebtor's books and records are disorganized and may be incomplete and inaccurate"<sup>105</sup>

The Commonwealth contends that the foundation and its president misrepresented and failed to disclose material facts regarding the anonymous donors.<sup>106</sup> It also contends that fraudulent conduct by the foundation and its president likely confused the contributors in the matching fund program.<sup>107</sup> The Commonwealth further contends that the foundation's and its president's conduct was consistent with an illegal Ponzi scheme.<sup>108</sup> The Commonwealth contends that the foregoing allegations of misrepresentation, failure to disclose and fraudulent conduct were in violation of the Unfair Trade Practices and Consumer Protection Law.<sup>109</sup>

The Commonwealth contends that the foundation's president failed to exercise the reasonable inquiry, skill and diligence as an ordinarily prudent

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<sup>105</sup>In re Foundation for New Era Philanthropy, Debtor's Emergency Motion to file its List of Creditors under Seal and for an Order directing Impoundment at ¶ 6.

<sup>106</sup>Commonwealth v. Foundation for New Era Philanthropy at ¶ 59.

<sup>107</sup>*Id.* at ¶ 60.

<sup>108</sup>*Id.* at ¶ 61.

<sup>109</sup>Act of December 17, 1968 (P.L.1224, No.387), § 2; 73 P.S. § 201-2. The Commonwealth requested that the court make this finding in ¶ 62 of its complaint in equity. It is doubtful that this statute applies. The Solicitation of Funds for Charitable Purposes Act identifies prohibited acts, act of December 19, 1990 (P.L.1200, No.202), § 15; 10 P.S. § 162.15 and specifies the criteria to determine unfairness in subsection (b) thereunder. "In determining whether or not a practice is unfair, deceptive, fraudulent or misleading under this section, definitions, standards or interpretations relating thereto under . . . the Unfair Trade Practices and Consumer Protection Law, shall apply." In other words, the section cited by the Commonwealth in Unfair Trade Practices and Consumer Protection Law determines whether or not the foundation violated the Solicitation of Funds for Charitable Purposes Act.



person would relating to the contributions.<sup>110</sup> This contention relates to a statutorily imposed fiduciary relation between a director and a nonprofit corporation.<sup>111</sup>

The Commonwealth also contends that the foundation failed to "maintain adequate books and financial records" and "failed to accurately disclose the names of the Foundation's board of directors."<sup>112</sup>

The Commonwealth requested that the court find the defendants to be in violation of sections 13(a)(d), 15(a)(2)(7), 21 and 5(f)(o) of the Solicitation of Funds for Charitable Purposes Act, section 2(4)(ii)(iii)(v)(xvii) of the Unfair Trade Practices and Consumer Protection Law and section 5712(a) of the Domestic Nonprofit Corporation Law of 1988.<sup>113</sup> The Commonwealth also requested injunctions against the defendants; an order for a complete, independent audit; imposition of a constructive trust upon all contributions received from Pennsylvania charitable organizations; a civil penalty for each violation of the Solicitation of Funds for Charitable Purposes

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<sup>110</sup>Commonwealth v. Foundation for New Era Philanthropy at ¶ 65.

<sup>111</sup>15 Pa.C.S. § 5712(a).

<sup>112</sup>Commonwealth v. Foundation for New Era Philanthropy at ¶¶ 66, 67. Nonprofit corporations are required to keep records of the names of the members of any body exercising powers as well as "appropriate, complete and accurate books or records of account." 15 Pa.C.S. § 5508(a).

<sup>113</sup>Commonwealth v. Foundation for New Era Philanthropy at ¶¶ 47, 51, 54, 57, 62 and 67.

Act; an award to the Commonwealth for its costs; and any other appropriate relief.<sup>114</sup>

The litigation of the Commonwealth has been stayed in order not to duplicate enforcement efforts by the U.S. Attorney for the Eastern District of Pennsylvania.<sup>115</sup>

### THE DIRECTORS

The foundation identified its president as John G. Bennett Jr.. The vice president for program management was identified as Mary Sinclair, and the directors were identified as Dr. John Brabner-Smith, Vivian W. Piasecki, Dr. John M. Templeton Jr., Charles D. Fulton and Dean Lind.<sup>116</sup>

Notwithstanding the board of directors, the Commonwealth alleges that the foundation's president "exercised sole control and authority over the activities of the Foundation."<sup>117</sup> News accounts support this allegation. On

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<sup>114</sup>Id.

<sup>115</sup>Personal interview with Janice L. Anderson, Chief Deputy Attorney General of the Charitable Trusts and Organizations Section (Sept. 26, 1995).

<sup>116</sup>The registration listed Dr. John Brabner-Smith as a director; however, the return listed Daniela Brabner-Smith as a director. Moreover, both the return and the registration were amended after being received by the bureau in May 1994. The amended documents were received by the bureau in July 1994. The documents filed in May listed Daniela Brabner-Smith, Piasecki, Dr. Templeton and Gene Fife as directors. The amended documents which were filed in July omitted Fife as a director and replaced him with Fulton and Lind. The amendments related solely to this information. Registration, item 24; Return, Part V.

<sup>117</sup>Commonwealth v. Foundation for New Era Philanthropy at ¶ 5.

Saturday, May 13, 1995, (the day before the foundation's president and his attorney signed the foundation's voluntary petition in bankruptcy) the foundation's president disclosed to its employees that the benefactors did not exist.<sup>118</sup> These benefactors were previously purported to have provided matching funds to contributions. Furthermore, one of the foundation's matching grant brochures claimed "[t]he President of the Foundation . . . is the only one who knows and communicates with the Benefactors."<sup>119</sup>

Vivian Piasecki did not realize that she was a "director" until after she had learned that the foundation listed her as one on its 1993 IRS filing. When she confronted the foundation's president, he represented to her that her "position was honorary and that board members would not be told the identities of the anonymous benefactors."<sup>120</sup> Her reported remarks are substantiated by the foundation's own IRS filing; the addresses of the directors listed by the foundation are all same, the foundation's location in Radnor.<sup>121</sup> Therefore, it is possible that any mail sent to the listed directors might not have been actually received by the directors.

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<sup>118</sup>Stecklow, *supra*, note 98.

<sup>119</sup>Mark Cohen, "Stars in their Eyes," *Philadelphia*, August 1995, 201.

<sup>120</sup>Jennifer Moore, Amanda Roque, Grant Williams, "How Did One Man Fool So Many?," *Chronicle of Philanthropy*, VII, no. 16 (1 June 1995): 26.

<sup>121</sup>100 Matsonford Road, Radnor 19087.

## FRAUDULENT ACTIVITIES

The Commonwealth alleges that the foundation established a fund to receive monetary deposits from nonprofit corporations whereby "[t]he Foundation claimed that it would double the nonprofit's contribution by matching a wealthy anonymous donor's money to that of the nonprofits."<sup>122</sup> "[T]he Foundation was to hold the nonprofit's funds for a fixed period of time which was agreed upon . . . and collect whatever interest accumulated on those funds for its use in administering the program . . . on the agreed upon date, the Foundation would issue a check on behalf of the participating donors doubling the nonprofit's original contribution . . ."<sup>123</sup>

Similarly, the Securities and Exchange Commission alleges that the foundation's brochure relating to New Concepts dated March 1994 was distributed containing these representations: investors' funds were to be kept for six months in a custodial account for safe, low-risk investments; investments of \$400,000 or more were to be kept in a quasi-escrow account with the investor being provided the name of the custodian, the name of the account's agent, the investment vehicle, the code designating the account, one authorized name to obtain that information; only Bennett was to know

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<sup>122</sup>Commonwealth v. Foundation for New Era Philanthropy at ¶ 9.

<sup>123</sup>*Id.* at ¶ 10. Perhaps donors with tax liability also deducted the interest retained by the foundation as a contribution. See Stecklow and Rebello *infra* note 166.

the benefactors providing matching funds; and the benefactors were to have guaranteed the matching funds via a three-year trust agreement.<sup>124</sup> The SEC further alleges that the foundation and its president did not register with it.<sup>125</sup> Similar to the Commonwealth's contentions, the SEC alleges that the foundation's president misrepresented material facts: there were never trust agreements with anonymous benefactors because there were never any anonymous benefactors, investors' funds were not invested solely in government securities, and investors' funds were not placed in custodial, escrow or quasi-escrow accounts.<sup>126</sup>

The foundation's trustee in bankruptcy, Arlin M. Adams, reportedly is considering suing the foundation's president and accounting firm along with Prudential Securities, Inc. possibly for violations of "securities law, federal racketeering laws, fraud, breach of contract, breach of fiduciary duty and negligence."<sup>127</sup>

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<sup>124</sup>Securities and Exchange Comm'n v. Bennett, Civil Action No. 95-CV-3005 at ¶¶ 15, 16 (E.D. Pa. filed May 18, 1995).

<sup>125</sup>*Id.* at ¶ 18.

<sup>126</sup>*Id.* at ¶¶ 24-27.

<sup>127</sup>Associated Press, "Trustee plans Lawsuit against Bankrupt Charity," Sunday Patriot-News, 30 July 1995, p. 4(B).



## **LEGAL ANALYSIS**

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Several aspects of the analysis correspond to the legal issues which are jurisdictionally divided between United States and Pennsylvania law, namely crime and securities. No federal criminal indictment has yet been sought. Litigation has commenced already in United States District Court for bankruptcy and securities violations.

Most of the law which controls the discharge of debt through bankruptcy proceedings is federal. To the extent that some creditors may not receive all of the funds which they invested or may not receive all the funds they were promised and to the extent that some creditors may be compelled to return some of the funds received, this case will be litigated as other similar bankruptcies are.

### **THE SOLICITATION OF FUNDS FOR CHARITABLE PURPOSES ACT**

It might prove far more beneficial to regulate charitable organizations more aggressively than to pass additional, perhaps redundant, laws which

are not or can not be vigorously enforced. One should consider the legislature's intention in enacting the Solicitation of Funds for Charitable Purposes Act.

It is the intention . . . that this act shall not merely require proper registration of charitable organizations, professional fundraisers and professional solicitors, but shall protect the citizens . . . by requiring full public disclosure of the identity of persons who solicit contributions from the public, the purposes for which such contributions are solicited and the manner in which they are actually used, by promoting consumer education about charitable concerns, by providing civil and criminal penalties for deception and dishonest statements and conduct in the solicitation and reporting of contributions for or in the name of charitable purposes and by publicizing matters relating to fraud, deception and misrepresentation perpetrated in the name of charity. This act shall not be construed to be exclusive in its purview, and its application shall not operate as a bar or . . . prevent the contemporaneous or subsequent application of any other relevant act or acts.<sup>128</sup>

This act broadly defines "charitable organization" to include any tax exempt person or any person who is established for a charitable purpose or employs a charitable appeal to solicit. Only organizations for those who ensure public safety, such as fire fighters, and religious institutions are excluded from this broad definition.<sup>129</sup>

The Secretary of the Commonwealth (the secretary) is empowered to: regulate registration of charitable organizations, professional fundraising

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<sup>128</sup>Act of December 19, 1990 (P.L.1200, No.202), § 2; 10 P.S. § 162.2.

<sup>129</sup>Id. at § 3; 10 P.S. § 162.3.



counselors and professional solicitors; promulgate, adopt and enforce necessary rules and regulations; alter fees and fines via regulation to meet the Bureau of Charitable Organization's expenditures; take action to initiate civil and criminal proceedings; adjudicate at hearings; record registrations; and report annually to the General Assembly.<sup>130</sup>

Charitable organizations must register and receive approval annually from the department before they are permitted to solicit contributions.<sup>131</sup> The registration statement must include, inter alia, a copy of the last filed IRS Form 990 and Schedule A and be accompanied with a financial report for the immediately preceding fiscal year which shall be audited by an independent public accountant.<sup>132</sup> Charitable organizations must maintain records for at least three years which must be available for inspection upon demand by the department and the Office of Attorney General.<sup>133</sup> The department is required to examine the documents filed by a charitable organization and determine whether the registration requirements are satisfied.<sup>134</sup> There are a few charitable organizations exempt from registration requirements such as educational institutions, hospitals and charitable organizations receiving

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<sup>130</sup>Id. at § 4; 10 P.S. § 162.4.

<sup>131</sup>Id. at § 5(a); 10 P.S. § 162.5(a).

<sup>132</sup>Id. at § 5(b)(6), (e), (f); 10 P.S. § 162.5(b)(6), (e), (f).

<sup>133</sup>Id. at § (5)(o); 10 P.S. § 162.5(o).

<sup>134</sup>Id. at § (5)(r); 10 P.S. § 162.5(r).

contributions of \$25,000 or less annually.<sup>135</sup> Professional fundraising counsel and professional solicitors must also register.<sup>136</sup> Information required to be filed with the department are public records open to the general public.<sup>137</sup>

Charitable organizations are required to keep true fiscal records for at least three years during which time they must be made available for inspection on demand by the department or Office of Attorney General.<sup>138</sup> A verbatim statement must be conspicuously printed on every printed solicitation, indicating that the charitable organization's official registration and financial information may be obtained from the department, and that "[r]egistration does not imply endorsement."<sup>139</sup> "A charitable organization may not misrepresent its purpose or nature or the purpose or beneficiary of a solicitation."<sup>140</sup>

The Solicitation of Funds for Charitable Act prohibits the following:<sup>141</sup>

- 15(a)(1) violations of the act and regulations or orders issued pursuant thereto
- 15(a)(1) soliciting without a valid registration

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<sup>135</sup>Id. at § 6(a); 10 P.S. § 162.6(a).

<sup>136</sup>Id. at §§ 8, 9; 10 P.S. §§ 162.8, 162.9.

<sup>137</sup>Id. at § 11; 10 P.S. § 162.11.

<sup>138</sup>Id. at § 12; 10 P.S. § 162.12.

<sup>139</sup>Id. at § 13(c); 10 P.S. § 162.13(c).

<sup>140</sup>Id. at § 13(d); 10 P.S. § 162.13(d).

<sup>141</sup>Id. at § 15; 10 P.S. § 162.15.

15(a)(2), (b) utilizing any unfair or deceptive act or practice or fraudulent conduct, as defined by the Unfair Trade Practices and Consumer Protection Law

15(a)(7) misrepresenting or misleading anyone with respect to goods and services or personal affiliations

The attorney general, the secretary or district attorney may investigate any person deemed necessary and issue subpoenas and conduct hearings in connection with these investigations.<sup>142</sup>

Any person who fails to appear or, with intent to avoid, evade or prevent compliance, in whole or in part, with any civil investigation under this act, removes from any place, conceals, withholds or destroys, mutilates, alters or by any other means falsifies any documentary material in the possession, custody or control of any person subject to any notice, or knowingly conceals any relevant information, shall be assessed a civil penalty of not more than \$5,000.<sup>143</sup>

Administratively, the secretary may revoke, suspend and refuse registrations for past or current violation of this legislation, a departmental regulation or secretarial order; failure or refusal to disclose required information; and a material false statement in a filing.<sup>144</sup> Additionally, the secretary may revoke exemptions, issue cease and desist orders, impose administrative fines and place registrants on probation.<sup>145</sup>

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<sup>142</sup>Id. at § 16(a); 10 P.S. § 162.16(a).

<sup>143</sup>Id. at § 16(f); 10 P.S. § 162.16(f).

<sup>144</sup>Id. at § 17(a); 10 P.S. § 162.17(a).

<sup>145</sup>Id. at § 17(b); 10 P.S. § 162.17(b).

The act supplies criminal and civil penalties. Willful and knowing violations of this act with an intent to deceive or defraud are misdemeanors of the first degree,<sup>146</sup> and any other violation of the act is a misdemeanor of the third degree.<sup>147</sup> Civil penalties, however, are much more comprehensive. The attorney general or any district attorney may sue to enjoin violations of this act and demand the appointment of a master or receiver, sequestration of assets, reimbursement of contributions, distribution of contributions, reimbursement of attorney fees and investigatory costs, a monetary civil penalty and any other appropriate relief.<sup>148</sup> Counties and municipalities may further regulate charitable solicitations.<sup>149</sup> Finally, a fiduciary duty is imposed on every person soliciting, collecting or expending contributions for charitable purposes and every person concerned with solicitation, collection and expenditure of contributions.<sup>150</sup>

## ENFORCEMENT EFFORTS

Enforcement efforts of the executive superficially appear to have been inadequate; however, a more measured analysis provides a better

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<sup>146</sup>*Id.* at § 18(a); 10 P.S. § 162.18(a).

<sup>147</sup>*Id.* at § 18(b); 10 P.S. § 162.18(b).

<sup>148</sup>*Id.* at § 19(a); 10 P.S. § 162.19(a).

<sup>149</sup>*Id.* at § 20; 10 P.S. § 162.20.

<sup>150</sup>*Id.* at § 21; 10 P.S. § 162.21. A breach of this duty which is owed to potential donors and recipients within the Commonwealth provides an additional cause of action under this act. *Commonwealth v. Cancer Fund*, 620 A.2d 647, 653 (Pa. Commw. Ct. 1993).

perspective. The department's Bureau of Charitable Organizations consists of a director and four clerical workers. The director of the bureau expects to employ an auditor soon.<sup>151</sup> There are no investigators employed. The bureau evidently was unaware of the foundation until the Office of Attorney General received an inquiry in 1993 relating to the legitimacy of the foundation.<sup>152</sup> The Office of Attorney General demanded, after consultation with the foundation, that it register with the bureau.<sup>153</sup> The foundation registered and paid \$1,000 for previous noncompliance.<sup>154</sup> Apparently, the department waived the audit requirement and accepted a financial statement in lieu thereof.<sup>155</sup> When an audit was unsubmitted in the renewal registration, the department denied the renewal and requested audited financial information. When a financial statement was submitted, an accompanying letter expressly stated that it is a review substantially less in scope than an audit.<sup>156</sup> Why this was accepted is unknown; however, the department and the Office of Attorney General attribute the erroneous acceptance to the lack

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<sup>151</sup>Personal interview with Karl Emerson, Director of the Bureau of Charitable Organizations (Sept. 22, 1995). Presumably, an auditor could at least spot check some of the thousands of filings.

<sup>152</sup>Personal interview with Janice L. Anderson, (Sept. 26, 1995).

<sup>153</sup>Id.

<sup>154</sup>Id.

<sup>155</sup>The department has discretion to require an audit or a review or, where special facts and circumstances are presented, accept an organization's financial statement in lieu of either an audit or review. Act of December 19, 1990 (P.L.1200, No.202), § 5(j); 10 P.S. §162.5(j).

<sup>156</sup>See supra note 22.

of departmental staff capable of reviewing financial statements.<sup>157</sup> The following year, the foundation obtained an extension to renew its registration but collapsed before the extension expired.

Nancy R. Axelrod, president of the National Center for Nonprofit Boards, attributes undetected charity fraud to weak enforcement of regulations rather than a lack of regulations.

[I]t is not a lack of regulations that has allowed charity fraud to go undetected. Instead, it is often weak enforcement by state attorneys general and the Internal Revenue Service that is to blame. Many of the government officials in charge of regulating charity behavior have too few resources to respond to the rising number of complaints they are receiving about charitable organizations. . . . [T]he regulators missed the many red flags that raised questions about New Era's legitimacy as a charitable organization. . . . It does not appear to have conducted financial audits or to have had a functioning board.<sup>158</sup> . . . [I]t is in the interests of charity

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<sup>157</sup>See *supra* notes 151, 152.

<sup>158</sup>Absent a bylaw adopted by members or another statutory provision, general powers of a nonprofit corporation "shall be exercised by or under the authority of, and the business and affairs of every nonprofit corporation shall be managed under the direction of, a board of directors." 15 Pa.C.S. § 5721. There were no members of the foundation to adopt a bylaw and a quick search has not revealed another statute providing otherwise; therefore, if this board was nonfunctioning, then another statute in the Nonprofit Corporation Law of 1988 may have been violated. Additionally, if the foundation's investment of \$1.1 million in a nonmarketable equity security, *see supra* note 62, proves to be an investment in a corporation in which an officer, Bennett, had a financial interest, it could be a breach of Bennett's fiduciary duty to the foundation and void or voidable. Voidableness can arise for a transaction between a nonprofit corporation and an interested officer if it was unauthorized by the board of directors, material facts relating to the interest or transaction were undisclosed to a board of directors authorizing the transaction or the transaction was unfair to the corporation when it was authorized by the board of directors. *See* 15 Pa.C.S. § 5728(a).

leaders to support rigorous enforcement of current state laws governing charitable organizations.<sup>159</sup>

Chief Deputy Attorney General Janice L. Anderson has discouraged new state or federal laws and "additional regulations in some knee-jerk reaction to this situation."<sup>160</sup>

It does not appear that the lack of regulations led to this debacle. The department certainly had too few resources to timely identify or investigate the foundation. Indeed, it has depended upon the Office of Attorney General for investigation when it has received complaints.<sup>161</sup> Last year, nearly 6,000 charitable organizations registered with the department and submitted financial information.<sup>162</sup> Additionally, more than 200 professional fund raising counsel and solicitors registered for the same year.<sup>163</sup> The department was not staffed to investigate or do much more than receive registrations.<sup>164</sup>

For its part, the charitable trusts and organizations section of the Office of Attorney General received an inquiry relating to the foundation in 1993. This was the first time that the Commonwealth's regulatory authorities

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<sup>159</sup>Nancy R. Axelrod, "Why Charities Were Vulnerable to New Era Scheme," Chronicle of Philanthropy, VII, no. 17 (15 June 1995): 43.

<sup>160</sup>Grant Williams, "End of New Era Sparks Renewed Debate Over the State of Charity Regulation," Chronicle of Philanthropy, VII, no. 16 (1 June 1995): 30.

<sup>161</sup>Personal interview with Janice L. Anderson (Sept. 26, 1995).

<sup>162</sup>Department of State, Charitable Organizations Annual Report July 1, 1994-June 30, 1995, vol. I.

<sup>163</sup>Id.

<sup>164</sup>Personal interview with Karl Emerson (Sept. 22, 1995).

heard of the foundation. Approximately two months after the Office of Attorney General contacted the foundation, the foundation registered with the department. About the same time, the Office of Attorney General referred its information to the IRS<sup>165</sup> because it recognized the possibility of tax fraud by identified donors, were those donors to deduct their donation plus the matched amount from the foundation's purported anonymous donors, after the designated recipient of the contribution sent a letter to the identified donor thanking the identified donor for the entire contribution.<sup>166</sup> It was not until March 1995,<sup>167</sup> that the Office of Attorney General discovered that the foundation submitted a review to the department in 1994 instead of the requisite independent audit.<sup>168</sup> Before spring of this year, the Office of Attorney General was unaware of the foundation's continued noncompliance with the Solicitation of Funds for Charitable Purposes Act and never received a complaint to investigate, other than the inquiry of 1993 which questioned the legitimacy of the foundation and prompted the registration demand. This was a situation where victims were unidentified until the foundation's collapse in May 1995; therefore, nobody complained of fraud prior to that time. Quite

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<sup>165</sup>Personal interview with Janice L. Anderson (Sept. 26, 1995).

<sup>166</sup>Steve Stecklow and Joseph Rebello, "IRS is Studying Whether New Era's Donor's Committed Fraud on Deductions," Wall Street Journal, 24 May 1995, p. 3(A).

<sup>167</sup>The SEC did not start investigating until after receiving a letter from Albert J. Meyer, a college faculty member, who was unsuccessful in deterring his college from sending money to the foundation. Barbara Carton, "A Persistent Accountant Helped to Expose Problems at New Era," Wall Street Journal, 19 May 1995, p. 2(B).

<sup>168</sup>Personal interview with Janice L. Anderson (Sept. 26, 1995).



simply, the charitable trusts and organizations section of the Office of Attorney General did not have a complaint upon which to act; however, this does not entirely excuse their failure to be proactive given the warning signs and the amount of money raised by the foundation.

The charitable trusts and organizations section employs six full-time and one part-time attorney, three permanent and one temporary secretaries, one paralegal and three investigators.<sup>169</sup> Unlike the complaint of inadequate staffing of the department's Bureau of Charitable Organizations, the chief deputy attorney general does not complain of inadequate staffing for this section; however, there is a vacancy in one of the investigatory positions for which the chief deputy attorney general regards as critical that she obtain a high quality investigator.<sup>170</sup> Of course, more quality employees can do more quality work; however, with this section enforcement was not a question of staffing.

The Commonwealth's Office of Attorney General and Department of State learned of the foundation's existence and novel scheme approximately 23 months prior to the foundation's collapse.<sup>171</sup> Until Tony Carnes, vice president of the International Research Institute on Values Changes in Briarcliff Manor, NY, contacted the Commonwealth in 1993 to inquire about

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<sup>169</sup>Telephone interview with Janice L. Anderson (Oct. 13, 1995).

<sup>170</sup>Id.

<sup>171</sup>Personal interview with Janice L. Anderson (Sept. 26, 1995).

the legitimacy of the foundation, the regulators were unaware of it.<sup>172</sup> Given the foundation's initial refusal and subsequent reluctance to comply with the Solicitation of Funds for Charitable Purposes Act along with a novel demand that potential grantees surrender funds to the foundation in order to receive a grant that could double these funds in six months, both should have been more vigilant. Bennett employed a commanding, personable charm that proved irresistible to those who are unfamiliar with the type.<sup>173</sup> The foundation's counsel was the second largest law firm in Philadelphia.<sup>174</sup> Bennett became acquainted with and pursued multimillionaires; some people representing the traditional establishment fell into his confidence. A man with these references might have been too intimidating for regulators who should have been more aggressively curious.

## THE CREDITORS

Robert S. Tigner, general counsel of the National Federation of Nonprofits and the Association of Direct Response Fundraising Counsel, also discourages additional regulations because the extra cost to responsible

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<sup>172</sup>Id.

<sup>173</sup>See generally Cohen, supra note 119.

<sup>174</sup>Stoiber, supra note 48.

charities will not benefit anybody if the additional regulations have little or nothing to do with what the charities do.<sup>175</sup>

It would be wonderful if we thought that the regulatory bodies could exercise more scrutiny to prevent this sort of risk, but . . . that's illusory. The state attorneys general never have enough staff or time to prevent something like this. Instead, what's important is common sense on the part of everybody who put the money up.<sup>176</sup>

Nancy R. Axelrod asserts that prevention of a similar reoccurrence rests with charity board members. Lack of board participation in fund raising is frequently mentioned by charity chief executives as a weakness of their governing bodies. Axelrod's commentary concludes by asserting that board members are trustees who must vigilantly ask difficult questions in order to carefully scrutinize transactions requiring their approval. "Good governance, not tougher investment policies or stricter regulation of non-profit groups, is the best way to prevent the next big charity scandal."<sup>177</sup>

James Bausch, president of the National Charities Information Bureau, likewise asserts "that nonprofit boards were less diligent than they needed to be, and that the absence of fail-safe regulatory machinery made New Era possible."<sup>178</sup> His commentary notes that the foundation never had

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<sup>175</sup>Williams, *supra* note 160.

<sup>176</sup>Quoting Harvey P. Dale, professor of law at New York University, at *id.*

<sup>177</sup>Axelrod, *supra* note 159.

<sup>178</sup>James Bausch, "Those Vexing New Era Questions," NonProfit Times, August 1995, 46.

a complete audit notwithstanding state charity regulation, showed absolutely no fund raising expenses, reported money as contributions rather than investments and liabilities, inexplicably listed grants to individuals, and distributed unsigned and undated office copies of tax returns for the years 1989 through 1992.

The IRS, state charity regulators and responsible "watchdogs" . . . can do a lot to encourage proper board governance procedures. But such external agents cannot do it all, or alone. The due diligence buck stops with the board of a nonprofit organization which needs to assure itself, and its contributors, that the right procedures and people are both in place and paid attention to.<sup>179</sup>

Some nonprofit corporations, however, may have attempted to be diligent. Karen Goldstein, executive vice president of the Franklin Institute, reportedly relied upon the institute's law firm's performance of due diligence regarding the foundation.<sup>180</sup> She also reportedly checked with the Office of Attorney General before reinvesting in the foundation.<sup>181</sup>

Robert A. Boisture, previous associate general counsel and director of public policy at the YMCA of the USA, encourages regulators to aggressively ensure that charity trustees meet their fiduciary obligations relating to investment decisions.

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<sup>179</sup>Id.

<sup>180</sup>Cohen, supra note 119, at 197.

<sup>181</sup>Id.

It used to be that regulators tried to prevent New Era-type deals by issuing a list of conservative investment tools and barring charities from investing in any items not mentioned on the list. But . . . charities campaigned successfully for the flexibility to use more sophisticated investment strategies to achieve a higher total return, without undertaking any unreasonable risks.<sup>182</sup>

Boisture advocates that boards obtain evaluations from disinterested outside experts on novel investment vehicles including derivatives and refuse to invest in anything they do not understand.<sup>183</sup> The foundation's

combination of promised matching gifts from anonymous donors with the requirement that charities turn over the funds to be matched was absolutely unprecedented. Under the circumstances, a board following the "don't invest in anything you don't understand" standard would have demanded reliable proof that this heretofore unknown species of anonymous donor did in fact exist. The obvious first step: Ask for a copy of New Era's audited financial statement to see if they confirmed the anonymous donors' existence and the nature and scope of their financial commitments.<sup>184</sup>

Boisture points out that the foundation never supplied audited financial statements to any charity because those statements did not exist, and some charities dealt with the foundation through intermediaries.<sup>185</sup>

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<sup>182</sup>Robert A. Boisture, "What Boards Should Learn From 'New Era' Case," Chronicle of Philanthropy, VII, no. 16 (1 June 1995): 40.

<sup>183</sup>Id. at 41.

<sup>184</sup>Id.

<sup>185</sup>Id. One such intermediary is reportedly the Blossom Foundation which "may have collected payments for linking up charities with New Era." G. Bruce Knecht, "Shaken Foundation: Baptist Parish Tries to Keep its Faith," Wall Street Journal, 23 May 1995, p. 8(A).

[T]he boards of charities that invested in New Era will bear a heavy burden in showing that they exercised reasonable care. . . . It would certainly appear that a significant percentage of charity boards have not established the basic investment policies and procedures required to meet their duty of care. Had those policies and procedures been in place, charities would have steered clear of New Era's matching grants.

We do not need new investment restrictions. But we do need to be sure charities are adhering to the legal requirements that are already on the books. . . . [R]egulators should treat the organizations that lost money to New Era as victims—but hold the board members accountable for their role in this debacle. At the very least, regulators should require the board of every organization that invested in New Era to prove that it has adopted policies and procedures to insure that . . . any non-traditional investment will be subject to close scrutiny . . . .<sup>186</sup>

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<sup>186</sup>Boisture, supra note 182, at 41.

This sound criticism of board governance<sup>187</sup> should concern those board members who authorized what in some cases may turn out to be the waste of other people's money. The administrators of at least one college victimized by the foundation were warned by an associate business professor of that college, who had persuaded most of the faculty to distrust the foundation, yet failed to heed his caution.<sup>188</sup> Every person concerned with expenditure of contributions for charitable purposes is "deemed to be a fiduciary and acting in a fiduciary capacity."<sup>189</sup> The Nonprofit Corporation Law of 1988 expressly states a director's standard of care.

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<sup>187</sup>Irving Warner, a fund-raising consultant, contends that this scandal "makes it painfully clear why we need a licensing system for fund raisers." Irving Warner, "Another Reason to License Fund Raisers," Chronicle of Philanthropy, VII, no. 19 (13 July 1995): 47. He proposes a "licensing program with teeth and ethical standards." Id. His proposal envisions proof of knowledge of fund-raising techniques, ethics and morals. Id.

Warner may have not fairly considered Pennsylvania's Solicitation of Funds for Charitable Purposes Act. Instead of requiring licensure, the Commonwealth mandates registration, a mandate the foundation ignored for approximately four years. (The requirements for registration and approval by the department of charitable organizations, fund raising counsel and contracts and professional solicitors already amounts to quasi-licensure.) Moreover, the act has teeth, civil and criminal penalties, and sensible standards, auditing and disclosure requirements. Vigorous enforcement of current law and regulation rather than initiation of an effectively redundant licensing program is a far more convenient and pragmatic approach. Ironically, the foundation demonstrated its high knowledge of fund-raising techniques, and knowledge of ethics and morals does not compel everyone to conform his conduct to ethical and moral behavior. Finally, Warner's column completely ignores the fiduciary duty and standard of care of board members.

A true licensing system necessarily limits the pool of those permitted to engage in the licensed activity. A bona fide practitioner of any potentially licensed activity naturally would advocate licensure. To do so protects not only the public from, perhaps, incompetent and unethical practitioners but also protects the practitioner from more competition.

<sup>188</sup>See supra note 167.

<sup>189</sup>Act of December 19, 1990 (P.L.1200, No.202), § 21; 10 P.S. § 162.21.

A director of a nonprofit corporation shall stand in a fiduciary relation to the corporation and shall 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.<sup>190</sup>

## SECURITIES LAW

The civil action filed by the SEC is based upon federal law; the litigation will be handled as other cases are handled when the same or similar allegations are made by the SEC. Along the same lines of the SEC complaint is the possibility of violations of the Pennsylvania Securities Act of 1972.<sup>191</sup> The definitions of security under Pennsylvania and United States statutes are similar.<sup>192</sup> While the United States District Court has ruled that it has jurisdiction in the SEC litigation, Bennett's attorney might again challenge jurisdiction.<sup>193</sup> Of course, the SEC contends that unregistered securities were offered while Bennett's attorney will probably assert that a

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<sup>190</sup>15 Pa.C.S. § 5712(a).

<sup>191</sup>Act of December 5, 1972 (P.L.1280, No.284), §§ 101-704; 70 P.S. §§ 1-101 to -704.

<sup>192</sup>Statutory provisions defining a security include any note, evidence of indebtedness, investment contract and any interest or instrument commonly known as or having the incidents of a security among other terms. *Id.* § 102; 70 P.S. § 1-102, 15 U.S.C. § 77b. Evidence of indebtedness is excluded; however, the other terms are included in the definition of security in 15 U.S.C. § 78c.

<sup>193</sup>Karen Donovan, "A New Era to Face SEC Fraud Claims," National Law Journal, 26 June 1995, p. 1(B).



matching gift program is not a securities offering.<sup>194</sup> This adjudication, of course, is unrelated to Pennsylvania law. Moreover, the Commonwealth's Office of Attorney General and Securities Commission will not duplicate federal legal action which would deplete resources were they to target the same actor regarding the same activities.<sup>195</sup> If and when the Securities Commission concludes that the Pennsylvania Securities Act of 1972 has been violated, it might take action against anyone it regards to have been a broker-dealer who induced a purchase of a security in the Commonwealth by a means of a fraudulent scheme or otherwise in violation of the act.<sup>196</sup> Popular news accounts indicate that consultants or corporations connected to consultants received bank transfers from colleges or other contributors to earmark that money for the foundation.<sup>197</sup>

The Joint State Government Commission does not have sufficient evidence to express an opinion whether the Pennsylvania Securities Act of 1972 has been violated. Senate Bill No. 1047<sup>198</sup> proposes adding a section to the Pennsylvania Securities Act of 1972 which would prohibit the sale of a security to a charitable organization whereby the purchase of the security

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<sup>194</sup>Id.

<sup>195</sup>Personal interview with Janice L. Anderson (Sept. 26, 1995); telephone interview with Michael J. Byrne, Director of the Division of Enforcement and Litigation for the Securities Commission (Oct. 11, 1995).

<sup>196</sup>Telephone interview with Michael J. Byrne (Oct. 11, 1995).

<sup>197</sup>Barbara Carton, "Who's News," Wall Street Journal, 19 May 1995, p. 1(B).

<sup>198</sup>Senate Bill 1047, Printer's No. 1418, introduced by Holl et al. (May 24, 1995), and passed the Senate (Oct. 17, 1995) by a vote of 47-1.

is a condition to receipt of a grant. This proposed legislation also would make willful violations of material provisions of some sections of the act a misdemeanor of the first degree and add restitution as a possible sentence. Willful violations of the section added by Senate Bill 1047 as well as the section relating to fraudulent sales and purchases<sup>199</sup> would be a felony of the third degree. This proposed legislation directly addresses the allegedly fraudulent practices of the foundation and toughens the criminal penalties.<sup>200</sup>

#### GENERAL INFORMATION ON FOUNDATIONS

The Foundation Center<sup>201</sup> counts 37,571 grant making foundations in the United States of America whose assets total \$189,213,483,000.<sup>202</sup> The figures for the most recent year show \$7,756,743,000 in received gifts, with grants totaling \$11,113,404,000.<sup>203</sup> There are several types of foundations. Independent foundations are private and typically founded by

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<sup>199</sup>Act of December 5, 1972 (P.L.1280, No.284), § 401(a)(c); 70 P.S. § 1-401(a)(c).

<sup>200</sup>The Pennsylvania Securities Act of 1972 provides for civil liabilities, *id.*, at § 501; 70 P.S. § 1-501, and criminal penalties, *id.*, at § 511; 70 P.S. § 1-511. Even if this act is inapposite, common law theories of recovery such as intentional misrepresentation or fraud and negligent misrepresentation may be available to parties victimized by the foundation's activities.

<sup>201</sup>"The Foundation Center is an independent national service organization established by foundations to provide an authoritative source of information on foundation and corporate giving." The Foundation Center, Guide to U.S. Foundations, their Trustees, Officers, and Donors, 1995 ed., vol. 1 (C. Edward Murphy ed., 1995), xxiii.

<sup>202</sup>*Id.* at ix.

<sup>203</sup>*Id.*

individuals and families.<sup>204</sup> These foundations grant money for charitable purposes to other tax exempt corporations. An example of an independent foundation is The Herbert A. Templeton Foundation;<sup>205</sup> an example of a family foundation is the Wood Foundation of Chambersburg, PA.<sup>206</sup> It is estimated that about two-thirds of American foundations are family ones and hold \$86 billion in assets.<sup>207</sup> Furthermore, estimated annual grants from family foundations total \$5 billion.<sup>208</sup> Community foundations are public charities because they raise a significant portion of funds from the public. These foundations typically receive donations from multiple donors and support local charity. There are more than 400 community foundations in our nation.<sup>209</sup> An example of this type of foundation is the York Foundation.<sup>210</sup> Another type of foundation is a corporate foundation which is an independent foundation established by a for-profit corporation to be a legally separate entity.<sup>211</sup> An example of this type of foundation is the Westinghouse Foundation.<sup>212</sup> Finally, another type of foundation is an operating foundation. Rather than granting money to charity, operating foundations use their

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<sup>204</sup>Council on Foundations, fact sheet, types of foundations 1995.

<sup>205</sup>Council on Foundations, 1994 Annual Report 35 (1995).

<sup>206</sup>*Id.* at 39.

<sup>207</sup>Council on Foundations, *supra* note 204, at 2.

<sup>208</sup>*Id.*

<sup>209</sup>The Foundation Center, *supra* note 201, at ix.

<sup>210</sup>Council on Foundations, *supra* note 205, at 42.

<sup>211</sup>The Foundation Center, *supra* note 201, at viii.

<sup>212</sup>Council on Foundations, *supra* note 205, at 43.

income to provide charitable programs and services.<sup>213</sup> An example of this type of foundation is The Carnegie Foundation for the Advancement of Teaching.<sup>214</sup>

Foundations grant money for charitable purposes or they use money to operate charitable programs. Foundations are public or private depending upon the source of the income. Foundations are independent because the source of funds (an individual, a family or a corporation) is private or public because the source of funds (donors from the community) is public. The Great Lakes Protection Fund is a public foundation and so is our subject, The Foundation for New Era Philanthropy.<sup>215</sup> Pennsylvania has 1,996 foundations with assets totaling \$14,093,795,000.<sup>216</sup> The figures for the most recent year show \$334,205,000 in received gifts with grants totaling \$1,129,975,000.<sup>217</sup>

Some donors wish to remain anonymous, and this wish is honored by recipient foundations. For example, of the funds of The Greater Harrisburg Foundation established prior to 1995, four donors funds are anonymous.<sup>218</sup> The sources of the remaining 226 endowment funds of The

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<sup>213</sup>The Foundation Center, *supra* note 201, at viii.

<sup>214</sup>Council on Foundations, *supra* note 205, at 43.

<sup>215</sup>*Id.* at 44.

<sup>216</sup>The Foundation Center *supra* note 201, at xiii.

<sup>217</sup>*Id.*

<sup>218</sup>The Greater Harrisburg Foundation, 1995 Annual Report 10, 13, 18, 22 (1995).

Greater Harrisburg Foundation are identified.<sup>219</sup> Foundations use some income (contributions) for expenses other than their programs, namely management and fund-raising expenses. The Foundation for New Era Philanthropy was unique because it borrowed money from its own grant recipients in order to pay its overhead.

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<sup>219</sup>Id. at 6-23.



## **CONCLUSION**

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The Solicitation of Funds for Charitable Purposes Act certainly addresses the activity of the foundation. As enacted, it should prove to be effective. In hindsight, regulatory efforts were too insufficient to prevent the foundation's apparent fraud. This act provides for its enforcement and additional regulation. The likelihood of creditors suffering a loss as a result of the bankruptcy petition is no different from the risk of similarly situated creditors in other bankruptcy proceedings. Law by its nature is retrospective; the hammer or the penalty is responsive to a violation. Perhaps the secretary should be more aggressive in suspending registrations and issuing cease and desist orders when registrants are delinquent in disclosing required information.<sup>220</sup> The law as written seems to strike a reasonable balance of regulation while giving those tasked with its enforcement seemingly reasonable discretion. It must be recognized that there will be

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<sup>220</sup>Nineteen cease and desist orders were issued during July 1, 1994-June 30, 1995. Department of State, Charitable Organizations Annual Report July 1, 1994-June 30, 1995, vol. I, at viii.

future victims of white collar crimes no matter how comprehensive the regulations and how severe the penalties.

Vigilance in the policing of charitable entities is certainly necessary because often the original donors are deceased, and the recipients are particularly meritorious. However, regulation must not become so onerous as to discourage citizens from pursuing charitable activities.