

MEMORANDUM

TO: Dr. Anne-Marie Izac
Chief Alliance Officer
Future Harvest Alliance Office

FROM: Celia Roady

DATE: August 25, 2006

SUBJECT: Pooling Center Reserves

I. Introduction

This memorandum responds to your request for advice, on behalf of the Future Harvest Alliance, on the following questions:

- (1) whether the 15 International Agricultural Research Centers (the “Centers”)¹ that comprise the Future Harvest Alliance have authority to pool their reserves for purposes of sharing financial risk;
- (2) if there are impediments to such pooling, whether they might be removed; and
- (3) whether there are opportunities for the pooling of reserves for other purposes, such as to achieve better and more cost-effective investment management services.

To facilitate review of this memorandum we begin with an executive summary of our conclusions.²

¹ The Centers are: Africa Rice Center (WARDA); Centro Internacional de Agricultura Tropical (CIAT); Center for International Forestry Research (CIFOR); Centro Internacional de Mejoramiento de Maiz y Trigo (CIMMYT); Centro Internacional de la Papa (CIP); International Center for Agricultural Research in the Dry Areas (ICARDA); International Crops Research Institute for the Semi-Arid Tropics (ICRISAT); International Food Policy Research Institute (IFPRI); International Institute of Tropical Agriculture (IITA); International Livestock Research Institute (ILRI); International Plant Genetic Resources Institute (IPGRI); International Rice Research Institute (IRRI); International Water Management Institute (IWMI); World Agroforestry Centre (ICRAF); and WorldFish Center.

² We note that the Centers are headquartered in some 14 different countries and understand that they have the status of international organizations under the laws of their host countries. The legal discussion set forth in this memorandum is based solely on our review of the Centers’ governing documents, funding mechanisms, the requirements for participation in the Consultative Group for International Agricultural Research (“CGIAR”) system and certain general principles of law governing U.S. charitable organizations. We are not admitted to practice in, and have not examined the laws of, the other countries where the Centers are headquartered and do not express an opinion on the implications of the questions presented under such laws.

II. Executive Summary

A. Do the Centers have authority to pool their reserves for purposes of sharing financial risk?

Based on our review of the ir governing documents and the manner in which they receive their funding, we do not believe that the Centers have authority to pool their reserves for purposes of sharing financial risk. We reach this conclusion for several reasons. First, each Center is a legally independent organization that is formed for separate and distinct purposes. Each Center's governing document sets forth that Center's purposes and only empowers the Center to engage in activities that further such purposes. While the governing documents of some Centers are broader than others, none of those we reviewed³ is broad enough to encompass the use of the organization's reserves to support other Centers with different purposes.

Second, governance of each Center is entrusted to a governing body that is tasked with the power and responsibility to apply the assets of the Center to the accomplishment of its specific purposes. None of the governing documents we reviewed gives the governing body control and discretion over the use of the organization's reserves for purposes unrelated to the Center's mission. Absent such discretion, the governing bodies of the Centers lack the authority to put the reserves of their Centers at financial risk for the benefit of other Centers with different purposes. Instead, the governing bodies have a responsibility to ensure that the Centers' resources are applied to support their particular missions.

Third, the Centers were (and are) funded by different donors. Each year these donors designate how much funding they wish to provide to specific Centers, as restricted (project-specific) or core (unrestricted) support, or both. Organizations are obligated to use donated funds for the specific purposes for which they were contributed in accordance with donor intent. In the case of unrestricted donations, there is an implicit donor expectation that funds will be used to carry out the purposes for which the organization was established.

B. Might it be possible to remove the impediments to such pooling of reserves?

We believe it would be extremely difficult to remove the impediments that exist to the pooling of reserves for purposes of sharing financial risk. At a minimum, this would require amending the governing documents of the Centers to permit the application of the reserves by one Center for

³ We have reviewed the following governing documents for the Centers, which were available to us from the CGIAR website: Constitution of the West Africa Rice Development Association; Constitution of The Centro Internacional De Agricultura Tropical; Constitution for The Center for International Forestry Research; CIMMYT, AC By-Laws; Amended Statutes of the International Potato Center; Diplomatic Immunities and Privileges (International Crops Research Institute for the Semi-Arid Tropics) Order 1988; Articles of Incorporation of The International Food Policy Research Institute; Constitution and Agreement on the Establishment of the International Livestock Research Institute and Host Country Agreement between ILRI and The Government of the Republic of Kenya; Agreement on the Establishment of the International Plant Genetic Resources Institute; Charter of the International Irrigation Management Institute; and the Charter of the International Council for Research in Agroforestry and Agreement between the Government of the Republic of Kenya and the International Development Research Centre acting as Executing Agency on behalf of a Group of Countries and Agencies Cooperating for the Establishment of the International Council for Research in Agroforestry.

the benefit of another. The amendment process varies from Center to Center; it typically requires approval of the governing body and in some cases approval of the CGIAR and/or the parties to the agreement establishing the Center. Making such amendments would be a complex and time-consuming process, and may not be in the best interests of individual Centers or consistent with the wishes of the donors to those Centers. Moreover, even if the governing documents were amended to permit the pooling or sharing of reserves, any such amendment might be viewed as applicable only to additions to reserves that accrue after the date of such amendment.

C. Are there opportunities for the Centers to pool reserves for other purposes, such as to achieve better and more cost-effective investment management services?

It would be possible for the Centers to pool some or all of their reserves for investment purposes. Indeed, the pooling of funds for investment purposes is quite common, and such arrangements do not involve the sharing of financial risk (beyond that inherent in the investment vehicle itself). Such pooling often enables the organizations to obtain higher quality and more cost-effective investment management, as well as greater opportunities for asset diversification. It would be possible, for example, to establish an investment partnership vehicle that could be used to manage pooled investments of the Centers. Under this arrangement, each Center that wished to participate would contribute a portion of its reserves to the partnership in return for a proportionate equity interest that would be shown as an asset on its financial statements.

Should the Alliance wish to pursue this opportunity, the next steps would include (i) determining which Centers might be interested in participating in an investment pool and the approximate amount of funds to be invested; (ii) preparing a “request for proposal” to be used to identify potential investment managers; (iii) development of appropriate investment guidelines for the pooled investment vehicle; (iv) selection of the jurisdiction where the investment vehicle will be created; and (v) preparation of legal documents that will govern the investment vehicle under the laws of the applicable jurisdiction.

III. Factual Background

The CGIAR is an association of more than 60 independent public and private sector members that provide strategic guidance and financial assistance to the Centers, which are the operational arm of the CGIAR system and carry out a research agenda approved by the CGIAR. The CGIAR operates in accordance with a Charter dated November 8, 2004. The Charter provides, with respect to the Centers, that

[e]ach Center is legally constituted as an independent, self-governing institution, with its own charter, research responsibilities or mandate, Board of Trustees, Director General and Staff, and budget; and functions under legal agreements with host countries. . . .

[g]uided by the mission of the CGIAR and its own research mandate, each Center formulates its strategic and medium-term plans in consultation with stakeholders and the Science Council . . .

Centers are financed primarily through annual grants from CGIAR Members who contribute to the Centers or programs of their choice.⁴

The CGIAR Charter also includes an Annex which contains the rules of procedure and related arrangements for the components of the CGIAR System. The Annex provides, with respect to the Center Boards, that

[t]he Center Board carries the *ultimate* responsibility for all aspects of Center strategy, financial integrity, risk management, human resource policy, and delivery of agreed outcomes . . .⁵

The Centers have entered into an alliance, called the Future Harvest Alliance, to promote collective action on major global issues for which no one Center could deliver alone. The Alliance also creates a mechanism for Centers to achieve economies of scale and to provide a forum for the Centers to discuss the implementation of the CGIAR mission at the operational level.

The Centers are established and headquartered in fourteen different countries around the world, including Benin, Columbia, India, Indonesia, Italy, Kenya, Malaysia, Mexico, Nigeria, Peru, Philippines, Sri Lanka, the Syrian Arab Republic and the United States. Each Center operates under its own governing document which sets forth the purposes, activities, governing structure and powers of the Center. While the specificity of the purposes, powers and activities described in the governing documents vary, the following excerpts from the Constitution of the Center for International Forestry Research (“CIFOR”) are illustrative of the level of specificity in the Centers’ governing documents that we have reviewed:

Article 4: Purpose

The purpose of the Center is to contribute to the sustained well-being of people in developing countries, particularly the tropics, through collaborative strategic and applied research and related activities in forest systems and forestry, and by promoting the transfer of appropriate new technologies and the adoption of new methods of social organization, for national development.

Article 6: Activities

CIFOR shall conduct, promote and support research that can provide the basis for sustainable forestry and forest systems in developing countries ...

CIFOR shall formulate a research program to underpin the science of forestry, by developing and maintaining the necessary scientific and technological base and the necessary staff expertise ...

⁴ CGIAR Charter Section III.D.3, 5 and 6.

⁵ CGIAR Charter Annex Section VIII.2 (emphasis in original).

CIFOR shall operate through a variety of mechanisms suited to the needs of its constituent programs, including networking, collaborative and contractual arrangements, and in-house research ...

CIFOR shall monitor forestry research globally and shall obtain and process information relevant to developing countries. CIFOR shall act as distributor of this information where and when it is needed ...

CIFOR shall keep itself informed of the policies, practices and capabilities of other agencies active in forestry and forestry research ...

CIFOR shall perform such other activities as its Board of Trustees may find necessary or useful in furtherance of its purpose set forth in Article 4 hereof ... (emphasis added)

CIFOR's activities shall contribute to increasing the forestry research capacity of developing countries ...

Article 7: Powers

- (i) In furtherance of the aforesaid aims and activities, CIFOR shall have the following powers:
 - (a) to receive or otherwise lawfully obtain from any governmental authority or from any corporation, company, association, person, firm, foundation or other entity whether international, regional or national, such charters, licenses rights, concessions or similar rights, and assistance – financial or otherwise – as are conducive to and necessary for the attainment of the aims of the Center (emphasis added);
 - (b) to receive, acquire or otherwise lawfully obtain from any governmental authority or from any corporation, company, association, person, firm, foundation or other entity whether international, regional or national, by donation, grant, exchange, devise, bequest, purchase or lease, either absolutely or in trust, contributions consisting of such properties, real, personal, or mixed including funds and valuable effects or items, as may be useful or necessary to pursue the aims and activities of the Center and to hold, operate, administer, use, sell, convey or dispose of the said properties ... (emphasis added);
 - (c) to perform all acts and functions as may be found necessary, expedient, suitable or proper for the furtherance, accomplishment or attainment of any and/or all of the purposes and activities herein stated, or which shall appear, at any time, as conducive to or necessary and useful for the aims and activities of the Center; ... (emphasis added)

- (ii) No part of the earnings of the Center shall inure to the benefit of, or be distributable to, its members, trustees, officers, or other private persons, except that the Center shall be authorized and empowered to pay reasonable compensation for services rendered and to make payments and distributions in furtherance of the purposes set forth in Article 4 hereof. (emphasis added)

The governing documents of the Centers generally set forth the provisions by which the documents can be amended. By way of example, CIFOR's Constitution provides that the document may be amended by a three-fourths majority of all voting members of the Board, provided they have received at least eight weeks' notice of the full text of the proposed amendment.⁶ In addition, amendments of certain fundamental provisions of the Constitution, including the purpose of the organization, require the approval of the parties to the Establishment Agreement by which CIFOR was founded. These include provisions relating to the status, country of location and purpose of the Center.⁷ The governing documents of some other Centers require CGIAR approval of any proposed amendments.⁸

The Centers receive most of their funding from the members of the CGIAR. As provided in the CGIAR Charter, each donor decides which Centers it wishes to fund, and whether to provide funding through restricted (project-specific) or core (unrestricted) support, or both. Each Center prepares and submits a three-year plan which forms the basis for unrestricted (core) support from donors, as well as proposals for specific projects which are submitted to donors and form the basis for restricted support.

As part of its financial oversight function, the CGIAR recommends that each Center maintain minimum cash reserves sufficient to fund 75 – 90 days of operation. Such reserves are available for a variety of purposes, including working capital and protection against a funding shortfall, uninsured damage to buildings and capital equipment due to natural disasters or civil strife, or other unanticipated losses or expenses. While some Centers have cash reserves that are at (or below) the minimum level, other Centers have significantly higher reserves. Each Center is responsible for investing its own reserves. Altogether the Centers have about \$156 million in cash reserves, enough to fund about 140 days of operations on a collective basis, well over the 75 – 90 day minimum recommended by the CGIAR. This has raised the question by some donors as to whether it would be possible to reduce the total size of the reserves by having the Centers pool all or part of their reserves.

⁶ Constitution for the Center for International Forestry Research, Article 21.

⁷ Ibid.

⁸ See, for example, Article 19 of the Constitution of the International Livestock Research Institute; Article Twelve of the Constitution of the Centro Internacional de Agricultura Tropical.

IV. Analysis

A. Authority of Centers to Pool Reserves for Purposes of Sharing Financial Risk and Resources

1. Relevant Principles

Nongovernmental organizations such as the Centers are generally bound by the terms of their governing documents, regardless of the form of organization. Many nongovernmental organizations are formed as nonprofit corporations or as trusts. Where the organization is formed as a nonprofit or charitable corporation, the corporate charter typically establishes its purposes, powers and authority, and the organization has no authority to engage in acts that are outside the scope of the charter.⁹

Where the nongovernmental organization is established in the form of a trust rather than a corporation, the terms of the trust are generally determined by the provisions of the trust document. Trusts formed for the public benefit are generally referred to as charitable trusts, and such trusts often enjoy favored status under the law.¹⁰ Nevertheless, their activities are still limited by the scope of their governing documents and trustees must manage the organization consistently therewith.

The boards of nonprofit organizations, whether corporate entities or trusts, are generally charged with responsibility for managing the affairs of the organizations.¹¹ Board members owe certain fiduciary duties in the performance of their duties and must act in a manner consistent with the purposes for which the organization was formed. Under U.S. law, these duties include the duty of care and the duty of obedience. The duty of care requires a director to act with the level of care that an ordinarily prudent person would exercise under similar circumstances and in a like position.¹² This standard of conduct extends to the directors' oversight of charitable assets and their investment and maintenance and would be implicated by board decisions that were outside or contrary to the corporation's purposes.¹³

The duty of obedience requires a director to act in a manner that is consistent with the corporation's central goals,¹⁴ and directors are entrusted with managing donated funds to fulfill the corporation's purpose. The diversion of funds from the corporation's mission is a violation

⁹ E.g., District of Columbia Nonprofit Corporation Act, § 29-301.05(16), holding that a nonprofit corporation shall "have and exercise all powers necessary or convenient to affect any or all of the purposes for which the corporation is organized."

¹⁰ Charitable trusts need not name specific beneficiaries and may continue for an indefinite duration. Restatement (3d) of Trusts, § 28, comments c and d (2003).

¹¹ E.g., District of Columbia Nonprofit Corporation Act, § 29-301.18; California Nonprofit Corporation Law § 5210.

¹² E.g., *Oberly v. Kirby*, 592 A.2d 445 (Del. 1991); New York Not-for-Profit Corporation Law § 717.

¹³ E.g., *Stern v. Lucy Webb Hayes National Training School for Deaconesses & Missionaries*, 381 F. Supp. 1003 (D.D.C. 1974); Uniform Management of Institutional Funds Act, § 6.

¹⁴ E.g., *Brown v. Memorial Nat'l Home Found.*, 329 P.2d 118 (Cal. App. 1958).

of this duty.¹⁵ A related doctrine prohibits directors from wasting corporate assets. “Directors are guilty of corporate waste, only when they authorize an exchange that is so one-sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration.” Generally, this doctrine provides a relatively low bar against the distribution of assets without consideration.¹⁶

In addition to these limitations, a nonprofit organization will also face restrictions on its ability to spend funds for purposes that differ from the terms under which they received such funds. For example, under U.S. law, organizations that accept donated funds are required to honor donor restrictions on the use of such funds, and may be required to return funds that are not used in accordance with the terms specified by the donor. Some U.S. jurisdictions have a particularly restrictive view of donor intent and apply the doctrine to preclude an organization that expands its charitable purposes from using pre-existing funds to support those expanded purposes. For example, some states take the position that all funds donated to an organization are impressed with a trust which requires that such funds be used only for the purposes of the organization existing at the time of the donation. In these cases, the net effect is that while the organization may amend its charter or trust agreement to expand its purposes, it may not use pre-existing funds but must instead raise new funds to carry out the expanded purposes.¹⁷

2. Application to Proposal for Pooling of Center Reserves

As described above, (i) nongovernmental organizations, whether formed as nonprofit corporations or trusts, are limited by the purposes set forth in their governing documents; (ii) directors or trustees of such organizations have no authority to engage in activities that are not consistent with the governing documents, and generally have fiduciary duties that require them to be faithful to the purposes for which their organizations were established; and (iii) organizations that receive funding from donors are obligated to use donated funds for the purposes for which they were contributed.

As reflected in the CGIAR Charter, the Centers are all formed as independent organizations that are governed by their own organizational documents. While the governing documents for the Centers vary, they all contain provisions setting forth the organizations’ purposes, activities and powers. Using the CIFOR Constitution as an example, the document states explicitly that the organization’s purposes and activities are directed at research in the field of forestry, and it includes several provisions that limit the use of the organization’s assets to the accomplishment of those purposes. None of the governing documents we have reviewed permits the Center Board to exercise complete discretion concerning the use of funds.

The Centers are governed by Boards that are charged, under the governing documents, with overseeing the activities of the organizations, which are directed to the purposes for which they were created. The Center Boards, as directors or trustees, will typically have fiduciary duties to ensure that the assets of the organizations are applied for the intended purposes. They are also

¹⁵ E.g., Matter of Manhattan Eye, Ear & Throat Hospital, 186 Misc.2d 126 (N.Y. Co. 1999).

¹⁶ Glazer v. Zapata Corp., 658 A.2d 176 (Del. 1993).

¹⁷ E.g., California Nonprofit Corporation Law § 5250.

responsible to Center donors for the use of Center resources in accordance with donor intent. Each Center has different donors, and has received contributions based on either specific project descriptions or core budgets that reflect the use of funds to support the Center's mission.

For these reasons, we do not believe that the Centers have authority to pool their reserves for purposes of sharing financial risk.

B. Potential Removal of Impediments to Pooling of Reserves

1. Relevant Authorities

The discussion above addresses the question of whether a nongovernmental organization has the power to use its financial resources for purposes other than those set forth in the governing document. Where such power cannot be found to exist, the next question is whether the governing document may be amended to provide such power, and if so whether such amendment might be effective with respect to reserves accrued prior to the date of amendment.

The requirements for amending the governing document of a nongovernmental organization are generally set forth in the document itself. Where the document is silent, the requirements may generally be found by reference to the law of the jurisdiction where the organization is formed. For example, the District of Columbia Nonprofit Corporation Act provides that the board of directors of a D.C. nonprofit corporation may, by majority vote of the directors in office, amend the articles of incorporation.¹⁸ In the case of a charitable trust, the general rule is that the trustee has no authority to amend the trust if the power to do so is not set forth in the trust document.

Assuming an organization's governing documents might be amended to broaden the permitted use of the organization's reserves, the concept of "donor intent" may, as discussed above, limit the applicability of such amendment to reserves accumulated after the date of such amendment.

2. Application to Potential Removal of Impediments to Pooling of Reserves

As discussed in Section 1 above, we believe that the Centers lack authority, under their governing documents, to pool their reserves for the purpose of sharing financial risk. The only way for the Centers to achieve such authority would be through the amendment of their governing documents. This would be a complex and time-consuming process at best, and Center Boards would be justifiably reluctant to consider any such amendment, particularly without the express consent of donors whose funding contributed to the accumulation of such reserves. Those organizations formed by treaty or agreement among founding organizations and/or governments would also likely want to assure that any amendments have the approval of the organizations' founders.

Moreover, even with such consents, it is unclear that the Boards of all Centers would consider such an amendment to be in the best interests of their organizations. Consistent with their fiduciary duties, the Boards of those Centers with significant reserves might wish to ensure the continued application of those funds to the purposes for which the organizations were originally

¹⁸ District of Columbia Nonprofit Corporation Code § 29-301.35(4).

established. Finally, there is a further issue as to whether any such amendment would be viewed as applicable only to reserves accumulated after the date of amendment.

C. Authority of Centers to Pool Reserves for Investment Purposes

1. Relevant Authorities

The fiduciary duties of directors and trustees of nongovernmental organizations include overseeing the prudent management of investments. Directors are required to exercise care and prudence in the exercise of their investment duties. Important components of investment oversight include the selection of competent investment professionals to provide investment management advice, the negotiation of reasonable fees for the services of such investment professionals, and the development of investment guidelines that are aligned with the organizations' needs and investment horizons and that give appropriate attention to the need for diversification. Common investment vehicles for nonprofit organizations include not only direct investments in equities and debt but also partnerships that pool funds from multiple related and/or unrelated partners for purposes of investment.

2. Application to Proposal for Pooling of Reserves for Investment Purposes

We believe it would be possible for the Centers to pool some or all of their reserves for investment purposes. It is common for charitable organizations to pool their reserves (or some portion of them) for investment purposes, and such arrangements do not involve the sharing of financial risk beyond that inherent in the investment itself. Such pooling often enables organizations to obtain higher quality and more cost-effective investment management, as well as greater opportunities for asset diversification. It would be possible, for example, to establish an investment partnership vehicle that could be used to manage pooled investments of the Centers. Under this arrangement, each Center that wished to participate would contribute a portion of its reserves to the partnership in return for a proportionate equity interest that would be shown as an asset on its financial statements.

Should the Alliance wish to pursue this opportunity, the next steps would include (i) determining which Centers might be interested in participating in an investment pool and the approximate amount of funds to be invested; (ii) preparing a "request for proposal" to be used to identify potential investment managers; (iii) development of appropriate investment guidelines for the pooled investment; (iv) selection of jurisdiction where the investment vehicle will be created; and (v) preparation of legal documents that will govern the investment vehicle under the laws of the applicable jurisdiction.

* * *

We appreciate this opportunity to be of service to the Future Harvest Alliance.