Before the Ohio House, Higher Education and Career Readiness Committee
Statement of Dr. Frederic Fransen, Ph.D. in support of Senate Bill 135

Good morning Chairman Lanese, Vice Chairman Young, Ranking Member Ingram and members of the committee. My name is Frederic Fransen. I reside in Fishers, Indiana, and I am here in support of SB 135.

For the past twenty-five years, I have been involved in education and philanthropy, with a particular emphasis on higher education philanthropy. On behalf of my clients, I have supervised grants to more than 90 different institutions of higher education. I have been involved in philanthropic transactions involving hundreds of millions of dollars. While I am neither an attorney nor an accountant, I have been deeply involved in structuring contracts and grant agreements designed to protect the interests of those making grants to universities, as well as the interests of universities themselves.

I would like to begin by emphasizing my deep, lifelong dedication to improving education at all levels. I do this work because I care about education, and in particular higher education. I believe that greater transparency and accountability are critical to preserving the leading role of American colleges and universities in teaching students and advancing research.

I support SB 135 precisely because I believe it will improve higher education. Absent such accountability, our non-profit institutions and particularly our universities will continue to bleed credibility and the goodwill that is essential to their ability to attract funds from well-meaning philanthropists, transferring more of the cost of education onto students and taxpayers and undermining their mission.

Such transparency and accountability is necessary because I have seen too many examples of bad faith on the part of universities, and in fact the current way in which many grants are negotiated by universities invites such bad faith.

One particular example is the fees universities charge and conceal from their donors. It is typical for universities to try to charge a fee on endowment accounts. They structure this in different ways, sometimes as an upfront "haircut" and other times as an ongoing annual fee, based on the asset value of the account. Sometimes it is both. Until the Great Recession of 2008, this was typically about 1.5% of the assets in the account (in addition to investment management fees). Since then, it has gone up.

One point five percent does not seem like a large amount. It is what many of us pay on our mutual fund accounts. But if one recognizes that programmatic payouts from an endowment account—that is, the funds actually spent each year on activity (whether for scholarships, research, teaching, or even the football team)—are often 4-4.5% of assets, then the administrative fee is actually 25% of the payout, and sometimes even more. Universities do not want contributors to know this.

Several years ago, I created a program to help philanthropists navigate university giving. The launch of the program was widely advertised, and one day I received a call from a senior member of the development team of an Ohio university (not Ohio State). He was curious about the program and how it would work. We had a pleasant conversation, toward the end of which he asked what fees we charged, and I told him between 8-9% of the first-year expenditure.

"That's way too high!" he responded.

Puzzled, I asked him what he charged.

"1.5% per year," he said.

"Of the asset base, or of the expenditure?" I asked.

"Of the asset base," he replied.

"Then you're really charging closer to 25%, if we're comparing apples to apples." That is, on a $100,000 endowment account, a payout of 4.5% generates $4,500 for the program, and $1,500 in fees. On a total payout of $6,000, therefore, you are keeping 25%!"

He suddenly got very angry. He ended the conversation by exclaiming that "If you keep saying these things to donors, we're going to sue you out of business." This is one example of the dirty little secrets of higher education philanthropy.

Universities have for a very long time been operating without adequate oversight of their grant agreements. Some years ago, on behalf of a major donor and board member of an East Coast university, I worked closely with the development office to create an innovative program. The purpose of the program was to encourage law students also to study business and then to consider careers in finance, rather than simply law. The long-term goal of this program was to create wealthier alumni, who would then become more generous supporters of the law school. It was designed as a scholarship program with an endowment in the tens of millions of dollars.

In designing the program, we incorporated a number of accountability measures including creating an advisory committee to provide regular oversight, and a five-year review of the program. After the agreement was signed, my involvement ended.

But five years later the donor's family office called, told me that they had questions about the implementation of the program, and asked me to conduct the five-year review contemplated in the agreement.

When I arrived, the universities development officer with whom I had worked invited me to dinner. She had been promoted since our first interaction, and she wanted to reconnect as well as introduce me to her colleagues. Late in the dinner, after she had had several glasses of wine, I remarked that my preliminary research seemed to indicate that they had implemented very little of what they had promised, and I asked how that could be, or whether I was missing something.

"Welcome to the world of big-dollar higher education fundraising," she replied, lifting her glass and offering me a toast.

The net result for this school of living in the world of "big-dollar higher education fundraising" was far fewer students having the opportunity to benefit from this innovative scholarship program.

Universities engage in such behavior for a variety of reasons. Lack of donor attentiveness is one of them. Recognition of the limitations on standing is another. Living donors have some rights. Heirs are much less likely to have standing to sue. The incentives for attorneys-general to intervene are small, and at least with public institutions, they have a built-in conflict of interest. Providing heirs or other trusted representatives to continue to hold recipient institutions accountable would go a long way toward increasing adherence to grant agreements.

If the problem were simply a matter of misunderstandings or lack of clarity, it would be one thing. But in my experience, universities are more than capable of engaging in practices that are ethically suspect. Several years ago, I was asked by a family foundation to review a grant agreement they were close to signing with a university in the northwest. The family sought to create a chair for the teaching of Austrian economics, and wanted the chair named for the Nobel prize economist Friedrich Hayek, one of Austrian economics' pioneers.

The grant agreement stipulated the name of the chair, but not the field of study, the family clearly understood however, what they had in mind.

When I met with university representatives and asked whether we could change the description of the chair to represent the substance of Hayek's work, rather than simply his name, the chair of the economics department blurted out that they "would never want to have a professor of Austrian economics"; the family had been ready to sign that day, but did not proceed with the gift.

This practice is not ideological. Jane Fonda and Garth Brooks have both had disputes over how their grants to universities were implemented. They had recourse because they were still alive and leverage because they were celebrities. But what about when a donor has passed? Universities are quite aware that both oversight and donor rights are weaker once the original donor is no longer alive. They are often in a position to play a long game.

For about ten years, I worked closely with university faculty from across the country and around the world. On several occasions, I was told by professors that their deans had publicly announced their determination to sift through old grant agreements and find funds that they could reallocate to new priorities. They would actively seek out poorly worded grant agreements with deceased donors, the deans promised, and then repurpose them. With no one watching, they felt no obligation to the terms of the agreements, even if the agreements were in perpetuity.

Moreover, it is common practice in the drafting of grant agreements for universities to insert provisions which eliminate protections against universities unilaterally repurposing grants. The normal procedure in such cases is that a court needs to review the grounds for repurposing and evaluate the claim that the new purpose is as close as possible to the original one.

When I see such clauses, I routinely remove them. No university has ever objected to me doing so; they realize that what they are doing is not defensible, and do not try.

This practice of not adhering to commitments would be comical, if not in such serious violation of the trust of the very people who seek to contribute to our educational institutions. Let me provide one more example.

When someone enters into an agreement to fund the construction of a building in return for the right to name it in perpetuity, they often fail to realize that “perpetuity,” in philanthropy, is not the same as “forever.”

After she retired, New York University naming rights negotiator Naomi Levine was quoted as saying that NYU no longer engraves contributors’ names on buildings, but rather bolts on metal lettering, in order to make it easier to change the name when the occasion warrants it (such as when a bigger donor comes along with a bigger gift).

SB 135 would go a long way toward alleviating such blatant violations of the trust of benefactors to our charitable institutions. Its principal purpose is to provide for the person making a grant to appoint a representative to monitor and intervene when a recipient institution fails to adhere to the terms of the grant. It continues to allow the attorney general to intervene, so long as he or she does so in a timely manner.

One might argue that allowing this bill to pass will open a Pandora’s box of litigation, encouraging donors’ successors to sue. I strongly disagree that this will be the case. The scope of remedy allowed by the bill strictly limits it to enforcing existing terms, not the ability to change the terms of a grant. Donor representatives will not be allowed to petition for the grant to be returned to them, either. Heirs and representatives therefore have no personal, financial incentive to do so. I have great difficulty imaging circumstance in which a donor representative would pursue such litigation frivolously, or for personal satisfaction.

Instead, representatives face the possibility of long and costly litigation, at the end of which they will at best only receive the satisfaction of knowing that the wishes and vision of their parent or grandparent are again being fulfilled—fulfilled in a way that the university agreed in advance.

One might also argue that allowing this bill to pass will reduce donors' willingness to invest in higher education (or charity more broadly). I also believe this is mistaken. One does not contemplate writing a check for millions, or tens or hundreds of millions of dollars, to any institution without a deep and abiding faith in the mission of that institution. In my experience, donors give institutions a huge benefit of the doubt when entering into discussions regarding a major grant. They often do so on the basis of long and deep relationships with fundraising officers and university leaders; in many instances, they believe they are dealing with friends. But those friends move on, and the implicit and explicit promises move on with them. What is left are words in agreements usually much more carefully crafted with the interests of the recipient in mind than those of the donor, and the biased interpretations of counsel for the recipient. Without the counterbalances envisioned by this bill, donors and their heirs will continue to see their intentions violated and their agreements ignored.

This problem is by no means limited to Ohio. I have been directly involved in donor intent issues in many states including, but not limited to Connecticut, New York, Maryland, Georgia, Florida, Texas, Arizona, Missouri, and other states, including Ohio.

With the passing of SB 135, however, Ohio stands to become a leader in restoring integrity to the world of higher education philanthropy. I therefore encourage its passage.