NOTE

THE PROBLEMS WITH PAYOUTS: ASSESSING THE PROPOSAL FOR A MANDATORY DISTRIBUTION REQUIREMENT FOR UNIVERSITY ENDOWMENTS

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I. INTRODUCTION

The endowments of wealthy colleges and universities became a subject of scrutiny in the popular press and in Congress in recent years, when the funds seemed to grow annually by the billions without fail. Their performance was so strong that they even inspired "how to" investment guides.[1] But this growing wealth was accompanied by questions about whether universities were doing enough to support student financial aid,[2] especially in light of rising tuition.[3] Critics accused universities of "hoarding" their wealth rather than using it to benefit current students.[4]

In response, lawmakers at the state and federal levels considered regulating or taxing university endowments.[5] The proposal that gained the widest

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[1] *See, e.g.*, MEBANE T. FABER & ERIC W. RICHARDSON, THE IVY PORTFOLIO: HOW TO INVEST LIKE THE TOP ENDOWMENTS AND AVOID BEAR MARKETS (2009); MATTHEW TUTTLE, HOW HARVARD AND YALE BEAT THE MARKET: WHAT INDIVIDUAL INVESTORS CAN LEARN FROM UNIVERSITY ENDOWMENTS TO HELP THEM PROSPER IN AN UNCERTAIN MARKET (2009).

[2] Charles E. Grassley, *Wealthy Colleges Must Make Themselves More Affordable*, CHRON. HIGHER EDUC. (D.C.), May 30, 2008, at 36; Goldie Blumenstyk, *Pressure Builds on Wealthy Colleges to Spend More of Their Assets*, CHRON. HIGHER EDUC. (D.C.), Nov. 2, 2007, at A1.

[3] SANDY BAUM & JENNIFER MA, COLL. BD. ADVOCACY & POLICY CTR., TRENDS IN COLLEGE PRICING 2010, at 13 (2010), *available at* http://trends.collegeboard.org/downloads/College_Pricing_2010.pdf (tracking the rise in tuition and fees from 1980–81 through 2010–11); Karen W. Arenson, *Soaring Endowments Widen a Higher Education Gap*, N.Y. TIMES, Feb. 4, 2008, at A14 ("Even as colleges race to raise their endowments, high tuitions have caused a backlash among parents, graduates and members of Congress, criticizing them for sitting on wealth.").

[4] *See, e.g.*, Carroll Bogert, Op-Ed., *Enjoy the Reunion. Skip the Check*, N.Y. TIMES, May 25, 2008, at WK11; Kevin Carey, *The 'Veritas' About Harvard*, CHRON. HIGHER EDUC. (D.C.), Oct. 2, 2009, at A25; John Hechinger, *When $26 Billion Isn't Enough*, WALL ST. J., Dec. 17, 2005, at P1.

[5] Grassley, *supra* note 2, at A36; Peter Schworm & Matt Viser, *Lawmakers Target $1b Endowments; Exempt Status of Schools Debated*, BOS. GLOBE, May 8, 2008, at A1 (detailing the request of a Massachusetts state legislator that state finance officials explore a plan impos-

traction would have required universities to spend at least five percent of their assets each year—a "mandatory payout."[6] Congress gave serious thought to this option[7] and one Congressman even proposed legislation requiring a payout, though he immediately withdrew it.[8] The criticism of endowments subsided with the recession. However, the possibility of a mandatory payout remains—and is likely to resurface when the endowment controversy resumes.

This Note focuses on the mandatory payout proposal.[9] More specifically, and consistent with scrutiny from lawmakers, it focuses on payout proposals targeting "the wealthiest" colleges and universities, herein defined as those with endowments greater than $500 million.[10] Part II of this Note provides an introduction to university endowments and the endowment controversy, including the payout proposal. It surveys the arguments for a payout offered by its proponents. Next, this Part traces the abatement of the controversy during the economic crisis and explains why we can expect scrutiny to return, possibly at an even greater intensity.

In Part III, this Note argues that state and federal lawmakers should not adopt a five percent payout requirement. First, it explains why the strongest

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ing a 2.5% tax on Massachusetts colleges and universities with endowments of $1 billion or more, of which there were nine at the time); Ian Urbina, *Pittsburgh Sets Vote on Adding Tax on Tuition*, N.Y. Times, Dec. 15, 2009, at A28.

[6] "Payout" (including "payout requirement" and "mandatory payout") and "minimum distribution requirement" are used interchangeably.

[7] See *infra* Part II.C for a detailed discussion of the payout proposal.

[8] *See infra* note 49 and accompanying text.

[9] This Note does not address other proposals for regulating or taxing endowments or endowment income, nor can it explore theories of endowment accumulation or endowment tax exemption. For excellent reviews of some of the regulations that have been proposed, see Mark J. Cowan, *Taxing and Regulating College and University Endowment Income: The Literature's Perspective*, 34 J.C. & U.L. 507 (2008); Sarah E. Waldeck, *The Coming Showdown over University Endowments: Enlisting the Donors*, 77 Fordham L. Rev. 1795, 1812–22 (2009). The foundational article on rationales for the existence of university endowments (and their accumulation) is Henry Hansmann, *Why Do Universities Have Endowments?*, 19 J. Legal Stud. 3 (1990). For discussion of university tax exemption, see John D. Colombo, *Why is Harvard Tax-Exempt? (And Other Mysteries of Tax Exemption for Private Educational Institutions)*, 35 Ariz. L. Rev. 841 (1993).

[10] *See, e.g.*, Brad Wolverton, *Senators' Letter Grills 136 Wealthy Colleges About Endowment-Spending and Financial Aid Policies*, Chron. Higher Educ. (D.C.) (Jan. 25, 2008), http://chronicle.com/article/Senators-Grill-Wealthy/439 (describing letters sent by the Senate Committee on Finance to colleges and universities with endowments of $500 million or more, requesting detailed reports on the institutions' endowments and spending rates). Referring to all institutions with endowments of $500 million or more as "wealthy" glosses over important differences in institutional student size and budget. See *infra* Part II.A for further discussion. A payout for institutions with smaller endowments has generally not been a subject of public or congressional scrutiny and raises separate issues. *See* Anthony W. Marx, Op-Ed., *Endowments 101,* L.A. Times, Oct. 12, 2008, at A27 (noting that institutions with smaller endowments, if subject to a payout, would be "at tremendous risk of burning through their funds during a downturn"); Shirley M. Tilghman, President, Princeton Univ., Remarks on Endowments and College Costs at the Roundtable on Endowments and College Costs (Sept. 8, 2008) (transcript available as prepared at http://www.princeton.edu/main/news/archive/S22/09/08G75) (arguing that a payout would "erode the flexibility [that less wealthy institutions] need to be able to increase their financial resources over time").

arguments offered by proponents of a mandatory payout are unpersuasive: a payout will not increase college affordability; the universities that would be subject to payout legislation are the wrong target because they already provide generous financial aid; universities, unlike foundations, are accountable to both internal and external agents who monitor their wealth; and it is inappropriate to compare universities to private foundations when they are far more similar to operating foundations, a special type of foundation with a lower payout requirement. Next, this Part explains why a payout will have harmful implications for colleges and universities: it will accelerate the so-called academic arms race, constrain institutions' ability to respond to economic fluctuations, risk harming American universities' international preeminence, and lead to a decrease in spending in the long term. A payout may also become a ceiling, incentivizing institutions not to spend above it. Finally, a payout will breach principles of university autonomy and academic freedom.

II. Background: Endowments and A History of Their Recent Scrutiny

A. *Endowments: Current Levels and Possible Measurements*

The endowment of a college or university is generally understood as its "total reserve funds," including stocks and other assets,[11] although the legal term "endowment" refers only to funds that a donor has restricted to a certain use.[12] An institution's total endowment is typically composed of thousands of smaller endowment funds that support particular areas "such as a named or endowed professorship, a scholarship, [or] a center."[13]

Harvard has the largest university endowment at $27.6 billion, followed by Yale ($16.7 billion), Princeton ($14.4 billion), the University of Texas ($14.1 billion system-wide), and Stanford ($13.9 billion).[14] Sixty-two universities have endowments of $1 billion or more, and 128 have endowments of $500 million or more.[15] During the recent economic recession, however, university endowments experienced significant losses: on average, a loss of

[11] Cowan, *supra* note 9, at 522; *see also* Ronald G. Ehrenberg, TIAA-CREF Inst., Demystifying Endowments 2 (2009), *available at* http://www.tiaa-crefinstitute.org/pdf/research/advancing_hi_ed/ahe_0709endowments_02.pdf.

[12] Cowan, *supra* note 9, at 522. Such endowments are typically referred to as "true endowments." Ehrenberg, *supra* note 11, at 2. In contrast, funds earmarked by an institution's trustees to support a specific area are referred to as "quasi-endowment," Cowan, *supra* note 9, at 522 n.90, or as "funds functioning as endowment," Ehrenberg, *supra* note 11, at 2.

[13] Cowan, *supra* note 9, at 522.

[14] Nat'l Ass'n of Coll. and Univ. Bus. Officers ("NACUBO"), 2010 NACUBO-Commonfund Study of Endowments, All U.S. and Canadian Institutions Listed by Fiscal Year Endowment Market Value and Percentage Change in Market Value from FY 2010 to FY 2009 (2011), *available at* http://www.nacubo.org/Documents/research/2010NCSE_Public_Tables_Endowment_Market_Values_Final.pdf.

[15] *Id.*

18.7% in fiscal year 2009, with the largest endowments (those over $1 billion) faring even worse, losing 20.5% on average.[16] Though endowments experienced positive returns in fiscal year 2010, averaging gains of 11.9%, most have not returned to their pre-recession levels.[17]

Despite the intuitive appeal of looking to these figures to ascertain institutional wealth, the absolute size of an endowment is actually a misleading measure for this purpose. Although "the $1 billion figure undoubtedly has appeal in part because it sounds so large and therefore is useful in helping to shock the public conscience,"[18] other metrics can provide valuable context for better understanding endowments and "wealth."

One such metric is the ratio of an institution's endowment to its operating budget, commonly termed the "endowment-to-expense ratio."[19] By comparing endowment to operating budget, the ratio "acknowledges that the strength of an endowment depends on the extent to which it can pay for institutional activities."[20] Research universities typically have far larger operating budgets than small liberal arts colleges due to factors such as the size of their physical facilities, the number of faculty and staff members, and the scale of the research in which they are engaged.[21] As a result, smaller colleges and universities rank highly among the "strongest" or "wealthiest" institutions according to this metric: the top five are Grinnell College (endowment-to-expense ratio of 16.52), Berea College (15.97), and Pomona College (13.65), followed by Princeton (13.16) and Rice Universities (11.79).[22] Research universities that appear far wealthier by absolute endowment value place quite low on this list. For example, Duke places thirty-fourth (3.11), the University of Pennsylvania places forty-fifth (1.95), and Johns Hopkins places fifty-sixth with a ratio of less than 1.00 (0.85), meaning that it spends more in a single year ($3.3 billion) than the value of its entire endowment ($2.8 billion).[23]

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[16] Press Release, NACUBO, Educational Endowments Returned -18.7% in FY2009, at 1-2 (Jan. 28, 2010), *available at* http://www.nacubo.org/Documents/research/2009_NCSE_Press_Release.pdf.

[17] Press Release, NACUBO, Educational Endowments Earned Investment Returns Averaging 11.9% in FY2010, at 2 (Jan. 27, 2011), *available at* http://www.nacubo.org/Documents/research/2010NCSE_Full_Data_Press_Release_Final.pdf. Across all institutions, endowments have experienced a three-year net return of -4.2%. *Id.*

[18] Waldeck, *supra* note 9, at 1800.

[19] See *id.* at 1799–1804 for a detailed discussion of this metric, and *id.* at 1826 for a table ranking the top sixty institutions according to 2007 endowment-expense ratios.

[20] *Id.* at 1800.

[21] *See id.* at 1800 ("Because the magnitude of activity is smaller at a liberal arts college, it needs fewer resources than a large research university."); *see also* Ronald G. Ehrenberg, Tuition Rising: Why College Costs So Much 146 (2002) (discussing the cost of operating and maintaining research universities' physical plants).

[22] Waldeck, *supra* note 9, at 1826. Waldeck's calculations are based on 2007 figures.

[23] *Id.* at 1827–28.

Economist Burton Weisbrod and others offer a similar "rainy day" metric.[24] Under this approach, one imagines that a university experiences a major financial setback such that it permanently loses ten percent of its revenue.[25] The institution is forced to finance the revenue cut by spending down its endowment until it must close its doors due to insolvency.[26] The question is how long the university's endowment will allow the institution to sustain itself. As one would expect based on the endowment-expense ratios, the small colleges fare well under this "rainy day" metric, as well: according to the calculations (based on 2006 figures) of Weisbrod and his co-authors, the top five institutions are Grinnell College, which could sustain itself for 191 years, Princeton Theological Seminary (184 years), The Curtis Institute of Music (155 years), Pomona College (149 years), and Berea College (148 years).[27]

A final important metric, the endowment per student ratio, accounts for the size of the endowment in relation to the size of the student body. This measure serves to distinguish between, for instance, a $1 billion endowment at a university with 30,000 students and a $1 billion endowment at a college with 3,000 students. According to 2007 figures, the five wealthiest institutions by this measure are Princeton ($2.23 million in endowment per full-time student), Yale ($1.98 million), Harvard ($1.77 million), Boston College ($1.67 million), and Stanford ($1.15 million).[28] Though several of the usual suspects are in this top five, smaller institutions are also particularly well-represented using the metric. For instance, Pomona, Grinnell, Amherst, Swarthmore, Williams, Wellesley, Berea, Dartmouth, and Bowdoin Colleges, as well as the California Institute of Technology, all make the top twenty.[29]

As these figures demonstrate, the absolute size of an endowment is not as indicative of institutional wealth as are measures that compare the endowment to student body size or operating budget. Some of the suggestions for payout proposals, discussed below, acknowledge this fact and do not appeal

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[24] Burton A. Weisbrod, Jeffrey P. Ballou & Evelyn D. Asch, Mission and Money: Understanding the University 142–44 (2008).

[25] *Id.* at 142. Weisbrod observes that Tulane University experienced a ten percent loss of funds following Hurricane Katrina. *Id.*

[26] *Id.*

[27] *Id.* at 143.

[28] Waldeck, *supra* note 9, at 1830.

[29] *Id.* The total enrollment of these ten institutions is 22,414 students (including graduate and professional programs). *See* Nat'l Ctr. for Educ. Statistics, *Search for Schools, Colleges, and Libraries*, NCES.ED.gov, http://nces.ed.gov/globallocator/ (Check "Colleges," search for relevant institution, and see "Total enrollment") (last visited Mar. 23, 2011). This is comparable to the total enrollment of a single large private research university such as Harvard (22,199), the University of Pennsylvania (21,668), or Columbia (21,105). Chron. of Higher Educ., *Campuses With the Largest Enrollments, Fall 2008*, Almanac of Higher Educ. 2010 (2010), https://chronicle.com/article/Campuses-With-the-Largest/124002/ (subscription required for access) (listing full-time-equivalent students). And it is far less than the total enrollment of some private research universities, such as New York University (36,057) or the University of Southern California (31,140). *See id.*

to absolute endowment size alone—most, however, use only absolute size, and may thus define "wealth" too broadly for sound policy-making.

B. The Rise of Endowment Scrutiny

Prior to the recession, universities enjoyed several years of remarkable endowment growth. From 2003 to 2007, the total endowment assets at all U.S. institutions nearly doubled, from $220 billion to $432 billion, adjusted for inflation.[30] Harvard's endowment, the largest throughout this period, grew from $18.8 billion[31] to $36.6 billion.[32] These rapidly increasing figures drew attention to endowments and to the disparities in resources between the "haves" and the "have nots" of educational institutions.[33]

When coupled with the fact that tuition prices continued to rise across the higher education sector during these years, including at the wealthiest schools,[34] institutions' growing endowments led to widespread criticism in the popular press[35] and in Congress.[36] Other factors contributed to the criti-

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[30] *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-10-393, POSTSECONDARY EDUCATION: COLLEGE AND UNIVERSITY ENDOWMENTS HAVE SHOWN LONG-TERM GROWTH, WHILE SIZE, RESTRICTIONS, AND DISTRIBUTIONS VARY 10 (2010), *available at* http://www.gao.gov/products/GAO-10-393.

[31] NACUBO, 2003 NACUBO ENDOWMENT STUDY, ALL INSTITUTIONS LISTED BY FISCAL YEAR 2003 MARKET VALUE OF ENDOWMENT ASSETS WITH PERCENT CHANGE BETWEEN 2002 AND 2003 ENDOWMENT ASSETS 1 (2004), *available at* http://www.nacubo.org/documents/research/FY03InstitutionListingForPress.pdf.

[32] NACUBO, 2008 NACUBO ENDOWMENT STUDY, ALL INSTITUTIONS LISTED BY FISCAL YEAR 2008 MARKET VALUE ENDOWMENT ASSETS WITH PERCENTAGE CHANGE BETWEEN 2007 AND 2008 ENDOWMENT ASSETS 1 (2009), *available at* http://www.nacubo.org/Documents/research/NES2008PublicTable-AllInstitutionsByFY08MarketValue.pdf.

[33] *See, e.g.*, Arenson, *supra* note 3.

[34] SANDY BAUM & JENNIFER MA, COLL. BD., TRENDS IN COLLEGE PRICING 2007, at 10 (2007), *available at* http://www.collegeboard.com/prod_downloads/about/news_info/trends/trends_pricing_07.pdf.

[35] Arenson, *supra* note 3; Blumenstyk, *supra* note 2; Waldeck, *supra* note 9, at 1798–99 (noting that "[b]etween January and March 2008, for instance, the *New York Times* published almost fifteen pieces that discussed endowments, college tuition, or the growing wealth gap between institutions of higher education").

[36] *See, e.g.*, *Offshore Tax Issues: Reinsurance and Hedge Funds: Hearing Before the S. Comm. on Fin.*, 110th Cong. (2007) [hereinafter *Offshore Tax Issues*]; *Report Card on Tax Exemptions and Incentives for Higher Education: Pass, Fail, or Need Improvement?: Hearing Before the S. Comm. on Fin.*, 109th Cong. (2006) [hereinafter *Report Card*]; Kelly Field, *Lawmakers Ease Pressure for Mandatory Endowment Payouts as Colleges Increase Aid for Students*, CHRON. HIGHER EDUC. (D.C.), Sept. 19, 2008, at A17; Kelly Field, *Shrinking Endowments Are Smaller Targets*, CHRON. HIGHER EDUC. (D.C.), Nov. 20, 2008, at A4; Grassley, *supra* note 2, at A36; Wolverton, *supra* note 10 ("Endowments have grown sharply in recent years while tuition on many campuses has climbed. That has led to growing pressure on institutions to curb tuition increases and spend more of their endowment assets to help students pay for college.").

This was not the first time such concerns were raised: in the late 1990s, universities also saw several years of strong endowment returns that were coupled with rising tuition. EHRENBERG, *supra* note 21, at 43. "The public became increasingly outraged that the payout rates at these institutions were so low relative to their endowment values at a time when many of the institutions were raising their tuition levels by substantially more than the rate of inflation." *Id.*

cism as well, including the high compensation of university presidents[37] and the seemingly low payout rates of endowments.[38] Critics accused universities of "hoarding" or "sitting on" their wealth due to the institutions' growing endowments and low payouts.[39] As a solution to the perceived hoarding, numerous commentators suggested the possibility of imposing a mandatory payout requirement for endowments.[40]

C. The Congressional Proposal: A Five Percent Mandatory Payout

During the recent controversy, the possibility of a mandatory payout arose as early as December 2006 in Senate Finance Committee hearings on

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[37] Unfortunately, it appears that far too many colleges' and universities' response to efforts to make college affordable by the Congress and by the private sector—particularly our Nation's elite institutions—has been a bad triple play: big tuition increases, expanding endowments, and now very, very high salaries for college presidents . . . .

Report Card, *supra* note 36, at 1 (opening statement of Sen. Charles E. Grassley, Chairman, S. Comm. on Fin.); *see also* Wolverton, *supra* note 10 (quoting Senator Grassley) ("'Tuition has gone up, college presidents' salaries have gone up, and endowments continue to go up and up.'"). The compensation of endowment managers may have played a role, as well. *See, e.g.*, Geraldine Fabrikant, *Harvard Endowment Managers Made $26.8 Million*, N.Y. TIMES, Dec. 20, 2008, at B2 ("In past years, the compensation of the endowment's managers prompted controversy because some academicians and alumni viewed it as excessive in the context of an academic institution.").

[38] *See, e.g.*, Arenson, *supra* note 3 ("Even as colleges race to raise their endowments, high tuitions have caused a backlash among parents, graduates and members of Congress, criticizing them for sitting on wealth.").

[39] Editorial, *Leave Endowments Alone*, USA TODAY, Mar. 27, 2008, at 10A; *see also, e.g.*, Bogert, *supra* note 4; Cowan, *supra* note 9, at 508; Grassley, *supra* note 2.

[40] RICHARD VEDDER, CTR. FOR COLL. AFFORDABILITY & PRODUCTIVITY, FEDERAL TAX POLICY REGARDING UNIVERSITIES: ENDOWMENTS AND BEYOND 15 (2008), *available at* http://www.centerforcollegeaffordability.org/uploads/Endowment_Report.pdf; Memorandum from Jane G. Gravelle, Cong. Research Serv., to Max Baucus, Chairman, S. Comm. on Fin., and Charles Grassley, Ranking Member, S. Comm. on Fin. 15 (Aug. 20, 2007), *available at* http://finance.senate.gov/newsroom/ranking/download/?id=f2ca39c7-f9e7-4ce0-8e76-2918f9758087 [hereinafter Gravelle Memorandum]; Chuck Grassley, *Spending to Save*, FORBES.COM (Aug. 13, 2008), http://www.forbes.com/2008/08/13/college-university-endowments-oped-college08-cx_cg_0813grassley.html.

The Filer Commission, a 1970s study of nonprofit groups, raised this possibility, as well. Cowan, *supra* note 9, at 548 n.311; Press Release, Sen. Charles Grassley, Grassley Urges Continued Look at College Endowment Growth, Student Affordability (Sept. 8, 2008), *available at* http://grassley.senate.gov/news/Article.cfm?customel_dataPageID_1502=16709. Importantly, neither Cowan nor Senator Grassley mention that although the Filer Commission endorsed the idea of a minimum distribution requirement for all nonprofits that are "endowed," including a five percent distribution for private foundations, the Commission expressly stated that "a lesser percentage (such as two thirds of the flat amount)"—or 3.33%—would be appropriate for "other endowed tax-exempt organizations." DEP'T OF THE TREASURY, RESEARCH PAPERS SPONSORED BY THE COMM'N ON PRIVATE PHILANTHROPY AND PUB. NEEDS ("FILER COMMISSION"), VOLUME I: HISTORY, TRENDS, AND CURRENT MAGNITUDES 28 (1977). Similarly, in its 1975 report, the Commission endorsed a five percent payout "for all exempt organizations with endowment resources," but then explained that "[f]or organizations other than private foundations . . . the payout rate should be set at a smaller percentage." THE COMM'N ON PRIVATE PHILANTHROPY AND PUB. NEEDS ("FILER COMMISSION"), GIVING IN AMERICA: TOWARD A STRONGER VOLUNTARY SECTOR 176 (1975).

tax exemptions in higher education.[41] Senator Charles Grassley (R-Iowa), one of the leading critics of endowments, asked in his opening statement if "colleges with big endowments [should] be required to pay out funds and dedicate some of those funds to keep tuition costs in check for working families."[42] The following year, a Congressional Research Service memorandum to Senators Grassley and Max Baucus (D-Mont.), Chairman of the Committee on Finance, explored policy options for setting endowment payout rates, including a flat rate or a rate tied to investment earnings.[43]

The Senate Committee on Finance held hearings in September 2007 that included discussion of university endowments. At these hearings, several members of Congress asked about a minimum payout.[44] The following year, Senators Grassley and Baucus sent letters to the 136 institutions that at the time had endowments of $500 million or more, asking them for information about their endowments and spending policies.[45] Further, Senator Grassley raised the mandatory payout possibility in two op-eds in major industry and popular press publications that year.[46] Then, in the fall of 2008, Senator Grassley and Representative Peter Welch (D-Vt.) hosted a roundtable discussion on university endowments in which mandatory payouts and their potential benefits were important topics.[47] To date, no federal payout legislation has been proposed formally,[48] except for an amendment to the Higher Education Act that Representative Welch briefly introduced and then withdrew.[49]

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[41] *Report Card*, *supra* note 36, at 2 (opening statement of Sen. Charles Grassley, Chairman, S. Comm. on Fin.).

[42] *Id.*

[43] Gravelle Memorandum, *supra* note 40, at 15.

[44] *Offshore Tax Issues*, *supra* note 36, at 22 (statement of Sen. Bunning) ("Do you [Jane Gravelle and Lynne Munson] believe a minimum payout requirement for universities with endowments of more than $1 billion would harm these institutions?"); *id.* at 26 (statement of Sen. Lincoln) ("You both [Jane Gravelle and Lynne Munson] have seemed to indicate that you could increase the mandatory endowment payout. Is that correct?"); *id.* at 28 (statement of Sen. Roberts) ("I think both of you [Jane Gravelle and Lynne Munson] have suggested that 5 percent could be a starting point for a payout requirement, consistent with that required of private foundations."); J.J. Hermes, *Senators Weigh Idea of Requiring Payout Rates for Large University Endowments*, CHRON. HIGHER EDUC. (D.C.) (Sept. 27, 2007), http://chronicle.com/article/Senators-Weigh-Idea-of/122124].

[45] Wolverton, *supra* note 10.

[46] Grassley, *supra* note 2 ("Legislation to require the wealthiest institutions to have an annual 5-percent endowment payout remains a possibility, as does increased reporting about endowment performance and expenditures."); Grassley, *supra* note 40 ("The benchmark could be a five percent annual payout rate for endowments above a certain amount.").

[47] *See* Press Release, Sen. Charles Grassley, Grassley, Welch Announce College Endowment Roundtable (Aug. 26, 2008), *available at* http://grassley.senate.gov/news/Article.cfm?customel_dataPageID_1502=16510.

[48] Goldie Blumenstyk, *Grassley: Colleges' Endowment Spending Is Still on the Front Burner*, CHRON. HIGHER EDUC. (D.C.) (Mar. 9, 2010), http://chronicle.com/article/Grassley-Colleges-Endowment/64572.

[49] The amendment "would have required colleges and universities with endowments of at least $500,000,000 to spend at least 5 percent of their endowment assets each year." Daniel Halperin, Does Tax Exemption for Charitable Endowments Subsidize Excessive Accumulation 5 (June 10, 2008) (working paper), *available at* http://papers.ssrn.com/sol3/papers.cfm?

The statements and actions of congressional actors up to this point suggest some basic parameters that would likely shape any future bills. Any legislation would probably apply only to institutions with absolute endowments valued above a certain floor, such as $500 million[50] or $1 billion.[51] The floor might also be based on endowment per student ratio, although no figures have been suggested.[52] While these were the most common proposals, other commentators envisioned payout requirements that would be triggered by tuition increases above certain levels or by other factors.[53] It is not clear if a payout requirement would apply only to private institutions or to both public and private institutions.[54]

abstract_id=1143458; *see also* Jonathan D. Glater, *House Passes Bill Aimed at College Costs*, N.Y. TIMES, Feb. 8, 2008, at A13.

[50] *See supra* note 49. Senator Grassley has also suggested this $500 million figure during congressional hearings. *Offshore Tax Issues*, *supra* note 36, at 32; *see also* Brad Wolverton, *More Endowment Scrutiny Likely, Former Senate Aide Says*, CHRON. HIGHER EDUC. (D.C.) (Mar. 25, 2008), http://chronicle.com/article/More-Endowment-Scrutiny/40691 (reporting that a former aide to Senator Grassley said that Congress remains interested in discussing a possible payout for institutions with endowments of $500 million or more). Additionally, the letter from Senators Grassley and Baucus regarding university endowments was sent to those institutions with endowments of $500 million or more. Wolverton, *supra* note 10.

[51] Karen W. Arenson, *Yale Plans Sharp Increase in Student Aid*, N.Y. TIMES, Jan. 15, 2008, at A14 (reporting that Senator Grassley "questioned why other colleges with endowments of more than $1 billion" did not increase their financial aid after Yale did so); *Offshore Tax Issues*, *supra* note 36, at 22.

[52] *Offshore Tax Issues*, *supra* note 36, at 15; Gravelle Memorandum, *supra* note 40, at 16; *see also* VEDDER, *supra* note 40, at 17 ("A good case can be made, however, that perhaps any rule should be based on endowment per student.").

[53] For a payout triggered by tuition increases, see Gravelle Memorandum, *supra* note 40, at 15. One economist suggested that a spending requirement could be designed to apply only to institutions whose endowment returns in the prior ten years exceeded a certain percentage. VEDDER, *supra* note 40, at 15. Another idea tied payouts to enrollment of a student body in which fewer than fifteen percent of the students were Pell grant recipients. Goldie Blumenstyk, *Why the Endowment-Spending Debate Matters Now More Than Ever*, CHRON. HIGHER EDUC. (D.C.), Mar. 7, 2010, at A18 (citing a proposal by Charles B. Reed, chancellor of the California State University system).

[54] A full exploration of these issues is beyond the scope of this Note; however, a payout that included public universities in its reach could face legal challenges and public disapproval in attempting to dictate how *state* institutions should manage their expenditures. *See* Charles Miller, *Endowment Reform: Why Federal Mandatory Payouts Are Unnecessary, Legally Dubious, and Counterproductive to Larger Higher Education Reform*, *in* CTR. FOR COLL. AFFORDABILITY & PRODUCTIVITY, UNIVERSITY ENDOWMENT REFORM: A DIALOGUE 5, 7 (2008), *available at* http://www.centerforcollegeaffordability.org/uploads/Miller_Munson_corrected.pdf ("There is also a fundamental states' rights issue for public university endowments, such as at my University of Texas's endowment . . . . What gives the federal government the right, in Texas language, to put their cotton pickin' hands on our money?"); Cowan, *supra* note 9, at 512 n.21 (concluding that most payout-related policy issues are the same for public and private institutions, but noting that imposing a payout on state institutions "could raise thorny political, as well as perhaps constitutional, issues"). Another important basis for distinction between public and private institutions is that far more of the endowment funds at public institutions (eighty percent) than at private institutions (fifty-five percent) are restricted by donors, Waldeck, *supra* note 9, at 1809, meaning that public institutions would have less flexibility in responding to a payout than private institutions would. The percentages can be even higher: at the University of Texas, for example, "less than half a percent of the total endowment is in the form of unrestricted monies." Miller, *supra*, at 9.

Specific suggestions for payout plans have varied. Although five percent is the figure most commonly cited for a payout requirement,[55] several commentators argue that the level could or should be higher.[56] Representative Welch stated in the fall of 2008 that he envisioned requiring a five percent floor over rolling three-to-five year periods.[57] Commentators also suggest that the payout could be "capped" so that when endowment earnings are low, the payout would not exceed the institution's earnings.[58] Finally, some payout proponents have suggested that universities' increased payouts should be specifically allocated to raising student financial aid and maintaining constant tuition levels.[59]

D. *The Arguments of Payout Proponents and the Comparison to Private Foundations*

Payout proponents' arguments in defense of their position should be surveyed briefly here, as a preliminary to further discussion. Among the principal arguments made in support of a mandatory payout is that such a requirement will increase college affordability, particularly for low- and middle-income families.[60] Proponents explain that a payout offers a means to limit tuition increases and boost financial aid to students.[61]

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[55] *See, e.g.*, Waldeck, *supra* note 9, at 1813; Hermes, *supra* note 44; Halperin, *supra* note 49, at 5 (discussing Representative Welch's proposal).

[56] VEDDER, *supra* note 40, at 15 ("A [five] percent spending rule seems extremely conservative."); Gravelle Memorandum, *supra* note 40, at 15; Lynne Munson, *Robbing the Rich to Give to the Richest*, INSIDE HIGHER ED (July 26, 2007), http://www.insidehighered.com/views/2007/07/26/munson ("And 5 percent should be considered just a starting point.").

[57] Clifford M. Marks & Peter F. Zhu, *Rep Pushes Payout Bill,* HARVARD CRIMSON, Oct. 9, 2008, *available at* http://www.thecrimson.com/article/2008/10/9/rep-pushes-payout-bill-a-us. Interestingly, in the interview in which he discussed using a rolling period, Representative Welch said that any legislation he proposed "would probably apply to all schools, not just Yale and its wealthy peers." Thomas Kaplan, *Endowment Spending May Be Mandated*, YALE DAILY NEWS, Oct. 8, 2008, *available at* http://www.yaledailynews.com/news/2008/oct/08/endowment-spending-may-be-mandated. This was not the position he took in his earlier proposal, which targeted institutions with endowments over $500 million, Halperin, *supra* note 49, at 5 n.11, and it runs counter to the majority of earlier-cited suggestions, which also focus on the wealthiest institutions.

[58] *Offshore Tax Issues*, *supra* note 36, at 28; Gravelle Memorandum, *supra* note 40, at 15.

[59] *See, e.g.*, Press Release, Sen. Charles Grassley, Endowments May Help Rein in Tuition Hikes (Oct. 29, 2007), *available at* http://grassley.senate.gov/news/Article.cfm?customel_dataPageID_1502=14508.

[60] *Offshore Tax Issues*, *supra* note 36, at 32 (statement of Sen. Grassley) (suggesting that Congress focus on wealthy "institutions . . . doing more and providing greater assistance to working families"); Marks & Zhu, *supra* note 57 ("The legislation [proposed by Representative Welch] follows nearly a year of threats from some lawmakers—notably Republican Senator Charles E. Grassley—to mandate a minimum level of endowment spending, which they say would increase college affordability."); Press Release, Grassley, *supra* note 59 ("[A]n endowment pay-out requirement ought to be included in the discussion to reduce tuition and help students afford college."); Hermes, *supra* note 44. *See generally* Grassley, *supra* note 2.

[61] *See, e.g.*, *Offshore Tax Issues*, *supra* note 36, at 133 (testimony of Lynne Munson) ("Possibly the most significant challenge to policymakers will be to make sure that any newly directed monies [from an increased payout] actually go toward aid or tuition reduction . . . .");

On a more principled level, payout proponents have called for increased accountability from universities[62] and have demanded that wealthy institutions justify their tax-exempt status.[63] These proponents see a distribution requirement as a way to increase accountability and make universities "earn" their exemptions by spending more, rather than letting their wealth accumulate tax-free.[64] Payout advocates also suggest that a distribution requirement would prevent universities from hoarding their wealth.[65]

Another common argument is that since private foundations are subject to a five percent payout rule, universities should be required to meet a similar requirement.[66] Private foundations are tax-exempt entities that are often controlled by a single donor or family and which engage in grant-making to other organizations, rather than carrying out their charitable activities directly (a distinction that will resurface later).[67] The Internal Revenue Code imposes a minimum distribution requirement on private foundations,[68] under which they must spend five percent of their net assets[69] each year on "qualifying distributions"—distributions that advance the foundation's religious, charitable, scientific, or otherwise exempt purpose(s)[70]—or face significant

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id. at 23 (testimony of Jane Gravelle) ("If Harvard was paying 4.5 percent and they paid out 5 percent, then they could double their undergraduate aid to middle- and lower-income families. They could avoid tuition increases, I believe, for the next 5 years . . . .").

[62] *See, e.g.*, Press Release, Grassley, *supra* note 59 ("As a strong proponent of openness in government, I'd like to shed the light of day on basic college endowment statistics.").

[63] *See, e.g.*, *Offshore Tax Issues*, *supra* note 36, at 23 (statement of Sen. Bunning) ("If the same rate of return that universities have experienced is continued for the next 20 years, then why are we allowing these endowments to be tax-free?"); Grassley, *supra* note 2 ("We Americans have decided that the work of nonprofit colleges and universities is so invaluable that they should be exempt from taxes. So John Doe pays taxes. John Deere pays taxes. But Johns Hopkins does not.").

[64] Tamar Lewin, *College Presidents Defend Rising Tuition, But Lawmakers Sound Skeptical*, N.Y. TIMES, Sept. 9, 2008, at A18 (noting the efforts of Sen. Grassley and Rep. Welch "to push universities to justify their tax exemptions by spending more of their endowment money").

[65] *See, e.g.*, Grassley, *supra* note 2 ("[D]on't some colleges cite excessive [donor] restrictions as an excuse to hoard rather than spend the [endowment] money?"); Hermes, *supra* note 44 ("[T]uition continues to climb at most universities, prompting some lawmakers and others to question what wealthy endowments are spending their money on, or whether they are hoarding their gains.").

[66] *See, e.g.*, Waldeck, *supra* note 9, at 1814; Press Release, Grassley, *supra* note 40; Munson, *supra* note 56.

[67] MOLLY F. SHERLOCK & JANE G. GRAVELLE, CONG. RESEARCH SERV., R 40919, AN OVERVIEW OF THE NONPROFIT AND CHARITABLE SECTOR 2, 39 (2009), *available at* http://www.fas.org/sgp/crs/misc/R40919.pdf.

[68] I.R.C. § 4942 (2006). Private foundations are subject to numerous other laws and regulations that are not herein addressed. *See id.* §§ 4940–45; *see also* BRUCE R. HOPKINS & JODY BLAZEK, PRIVATE FOUNDATIONS: TAX LAW AND COMPLIANCE 3 (3d ed. 2008).

[69] I.R.C. § 4942(e)(1) (2006); *see also* I.R.S., INTERNAL REVENUE MANUAL 7.27.16.2 (2010), *available at* http://www.irs.gov/irm/; HOPKINS & BLAZEK, *supra* note 68, at §§ 6.1–6.8.

[70] I.R.C. § 4942(g) (2006).

excise taxes.[71] The comparison between the foundation payout and a university endowment payout will be addressed in detail *infra* at Part III.A.4.

These criticisms of universities generally subsided, however, during the economic recession.

E. The Economic Downturn: Criticism Subsides Nationally, But Persists Locally

As noted above, university endowments lost an average of 18.7% of their value in fiscal year 2009, with endowments greater than $1 billion losing an even higher 20.5% on average.[72] In the fall of 2008, *The Chronicle of Higher Education* suggested a possible "silver lining" to campuses' budget woes: "[c]olleges' investment losses could ease Congress's demands for mandatory endowment payouts, at least in the short term."[73] Senator Grassley's remarks at the 2008 endowment roundtable that "a lot of the things that needed to be corrected were self-corrected" fueled a sense that congressional scrutiny was abating.[74]

Given the steep losses in endowment values and general preoccupation with more pressing matters, endowment scrutiny indeed subsided. As one scholar explained, "congressional interest in spending policies may seem like a relic from healthier times."[75] There were no letters, hearings, or roundtables on the issue after the fall of 2008.[76]

The issue nevertheless lurked beneath the surface of congressional activity. In a January 2009 press release, Senator Grassley called on institutions to spend more on student aid precisely because of the economy. "If an endowment is a rainy day fund, it's pouring," he wrote.[77] "Colleges' smart saving and investing could really help students right now."[78] *The Chronicle*

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[71] I.R.C. § 4942(a)-(b) (2006); *see Taxes on Failure to Distribute Income*, IRS.GOV, http://www.irs.gov/charities/foundations/article/0,,id=137632,00.html (last updated June 16, 2010); *see also* HOPKINS & BLAZEK, *supra* note 68, at § 6.7.

[72] *See supra* note 16 and accompanying text.

[73] Field, *Shrinking Endowments Are Smaller Targets*, *supra* note 36.

[74] Lewin, *supra* note 64, at A18.

[75] Waldeck, *supra* note 9, at 1822.

[76] However, two government reports touched briefly on the topic. *See* SHERLOCK & GRAVELLE, *supra* note 67 (devoting one paragraph to the 2007–08 scrutiny of endowments); U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 30 (declining to make a recommendation regarding endowments).

[77] Press Release, Senator Charles Grassley, Grassley: College Endowment Volatility is Not Excuse for Skirting Student Affordability (Jan. 27, 2009), *available at* http://grassley.senate.gov/news/Article.cfm?customel_dataPageID_1502=18959.

[78] *Id.* Lynne Munson, who encouraged a payout when she testified before Congress in 2007, *Offshore Tax Issues*, *supra* note 36, at 16, wrote a letter to the editor of the *Chronicle of Higher Education* in March 2009 urging colleges to spend more. Lynne Munson, Letter to the Editor, *Colleges Still Have Money Enough to Spare*, CHRON. HIGHER EDUC. (D.C.), Mar. 13, 2009, at A36.

reminded readers in early 2010 that Senator Grassley "hasn't forgotten about college endowments."[79]

During the recession, an offshoot of the endowment controversy also appeared in cities and municipalities across the nation. Local governments pressed their neighborhood (and property tax-exempt) universities, particularly wealthy ones, to help support the payrolls of the struggling cities.[80] Thus, although congressional scrutiny and calls in the national press for higher payouts may have subsided, at least temporarily, local communities still took notice of large endowments. The question never fully disappeared—and it is poised to return.

F. Why the Criticism Will Resurface

The public criticism of endowments will resurface, possibly with a vengeance, for several reasons. First and foremost, in the last year universities have again seen positive investment returns.[81] Harvard, for example, posted an eleven percent return[82] and added $1.5 billion to its endowment in fiscal year 2010, increasing its total value from $26.1 billion to $27.6 billion.[83] While these gains are far from those seen in 2007 (when Harvard posted a twenty-three percent return[84] and Yale, as another example, posted a twenty-eight percent return[85]), they are nonetheless significant. They have already drawn attention and will continue to do so.[86]

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[79] Blumenstyk, *supra* note 53, at A18 ("Although health care and jobs now preoccupy Congress, Senator Grassley says his fervor for the [endowment debate] remains.").

[80] *See* Karin Fischer, *Towns, Gowns, and Taxes: Higher Education Helped Save Pittsburgh, So Why Are the Two Sides Still Fighting?*, CHRON. HIGHER EDUC. (D.C.), Feb. 1, 2010, at A1 (describing the City of Pittsburgh's proposed one percent "Fair Share Tax" on tuition); Eric Kelderman, *Colleges and Cities Square Off over Tax Demands*, CHRON. HIGHER EDUC. (D.C.), Jan. 31, 2010, at A30 ("[T]he pressure on colleges to contribute more to municipal government will probably continue as long as the economy is struggling."); Ian Urbina, *Pittsburgh Council is Set to Vote for Tax on Tuition*, N.Y. TIMES, Dec. 15, 2009, at A28; Moira Herbst, *Princeton as 'Hedge Fund' Foiling Residents Seeking Relative Share of Taxes*, BLOOMBERG.COM (June 29, 2010), http://www.bloomberg.com/apps/news?pid=Washingtonstory&sid=AAAKbz7mpys4.

[81] *See, e.g.*, Press Release, NACUBO, *supra* note 17.

[82] Beth Healy, *A New Year at Harvard; Endowment Gains 11%, But Trails Market*, BOS. GLOBE, Sept. 10, 2010, at B7.

[83] HARVARD UNIV., HARVARD UNIVERSITY FINANCIAL REPORT: FISCAL YEAR 2010, at 5 (2010), *available at* http://cdn.wds.harvard.edu/fad/2010_full_fin_report.pdf.

[84] HARVARD UNIV., HARVARD UNIVERSITY FINANCIAL REPORT: FISCAL YEAR 2007, at 4 (2007), *available at* http://vpf-web.harvard.edu/annualfinancial/pdfs/2007fullreport.pdf.

[85] YALE UNIV., YALE UNIVERSITY FINANCIAL REPORT 2006-2007, at 14 (2007), *available at* http://www.yale.edu/finance/controller/resources/docs/finrep06-07.pdf.

[86] *See, e.g.*, Hillary Canada, *Survey Says: Colleges Saw Turnaround in 2010*, WALL ST. J. PRIVATE EQUITY BEAT (Jan. 27, 2011, 6:26 PM), http://blogs.wsj.com/privateequity/2011/01/27/survey-says-colleges-saw-turnaround-in-2010/; *see also* Geraldine Fabrikant, *Harvard Endowment Reports 11% Return for Year*, N.Y. TIMES, Sept. 10, 2010, at B3; Tamar Lewin, *Endowments at Universities See Gains After 2009 Losses*, N.Y. TIMES, Jan. 27, 2011, at A18 ("Senator Charles E. Grassley . . . said Wednesday that the [NACUBO] survey strengthened the case for revisiting endowment payout policies.").

Second, tuition has continued to rise, outpacing inflation,[87] and the total cost of attendance at the most expensive institutions will soon surpass $60,000.[88] This comes with the significant caveat that net tuition and fees—the actual cost to families, once institutional financial aid and federal tax breaks are taken into account—have actually dropped in constant 2010 dollars in the five-year period between 2005–06 and 2010–11.[89] Nonetheless, critics have tended to focus on the so-called "sticker price" tuition and fees, as have students and parents.[90] It is therefore the growth in sticker price that will likely reinvigorate calls for endowment regulation.

Third, one widely cited study from May 2010 argued that the investment practices of university endowments were partly to blame for bringing about the economic crisis.[91] According to the report, universities contributed to the crisis by adding both capital and "academic credibility" to risky investment strategies.[92] The study received attention in industry publications and the popular press,[93] and will likely be cited in calls for endowment regulations.

Fourth, saving for a "rainy day" is one of the primary justifications for the existence of endowments.[94] The country has experienced just such a "rainy day," as Senator Grassley noted, but it is not yet clear how universities responded.[95] Statistics from the annual endowment study of the National Association for College and University Business Officers ("NACUBO") show endowment payout *rates* rose,[96] but it is not known if *spending* on

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[87] Baum & Ma, *supra* note 3, at 13.

[88] Kim Clark, *Here Come $60,000-A-Year Colleges: Many Elite Colleges Are About to Break the $60,000 Price Barrier*, U.S. News & World Rep. (Oct. 12, 2010), http://www.usnews.com/education/articles/2010/10/12/here-come-60000-a-year-colleges.

[89] Baum & Ma, *supra* note 3, at 15.

[90] *See, e.g.*, *Offshore Tax Issues*, *supra* note 36, at 14–16, 22–23, 31–32; Baum & Ma, *supra* note 3, at 8 ("Although it is generally the published prices that make headlines, it is the net prices paid by individual students that matter most for college access and affordability."); Marx, *supra* note 10, at A27.

[91] Joshua Humphreys, Tellus Inst., Educational Endowments and the Financial Crisis: Social Costs and Systemic Risks in the Shadow Banking System (2010), *available at* http://www.tellus.org/publications/files/endowmentcrisis.pdf.

[92] *Id.* at 4, 12.

[93] Jennifer Epstein, *Questioning Endowment Losses*, Inside Higher Ed (May 21, 2010), http://www.insidehighered.com/news/2010/05/21/endowments; Paul Fain, *Wealthy University Endowments Helped Fuel Financial Crisis, Report Says*, Chron. Higher Educ. (D.C.) (May 21, 2010), http://chronicle.com/article/Wealthy-University-Endowments/65641; Gillian Wee, *Harvard, Dartmouth Helped Deepen Crisis, Report Says*, Bloomberg Businessweek (May 20, 2010, 2:07 PM), http://www.businessweek.com/news/2010-05-20/harvard-dartmouth-helped-deepen-crisis-report-says-update1-.html.

[94] *See, e.g.*, Hansmann, *supra* note 9, at 21–26 (explaining that universities maintain endowments to protect against the ill effects of financial setbacks); Waldeck, *supra* note 9, at 1807–08.

[95] For a review of the responses of several elite universities, see Peter Conti-Brown, *Scarcity Amidst Wealth: The Law, Finance, and Culture of Elite University Endowments in Financial Crisis*, 63 Stan. L. Rev. app. A (forthcoming 2011), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1444978.

[96] Institutions with endowments of $1 billion or more increased spending rates from 4.2% in fiscal year 2008 to 4.6% in fiscal year 2009, and then again to 5.6% in fiscal year 2010. The

financial aid rose, stayed at the same levels, or even decreased. As to the last possibility, one recent study found that in past recessions, selective institutions reduced financial aid.[97] If subsequent reports find that universities reduced financial aid, this behavior may hurt universities' public image and their position in the debate over regulating endowments.

Finally, after recent scrutiny of the for-profit education sector,[98] commentators predict coming oversight of the nonprofit education sector, as well.[99] Some of the topics that may see greater scrutiny are rising tuition and student debt levels.[100]

III. Assessing the Payout Proposal

If endowment scrutiny returns in earnest, lawmakers may once again be tempted to consider a payout plan. However, state and federal legislatures should not adopt a minimum distribution requirement and should instead consider other options for university endowments.

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spending rates of institutions with endowments of $501 million to $1 billion were 4.5%, 4.9%, and 5.7% during that same period. NACUBO, 2010 NACUBO-Commonfund Study of Endowments, Average Annual Spending Rates, 2010 to 2011 (2011), *available at* http://www.nacubo.org/Documents/research/2010NCSE_Public_Tables_Spending_Rates_Final_January102011.pdf.

[97] Based on evidence from the 2000–02 technology bubble collapse, a 2010 study of universities' responses to financial shocks found that "more selective universities cut back on student financial aid to incoming freshman [sic] following a negative financial shock." Jeffrey Brown et al., *Why I Lost My Secretary: The Effect of Endowment Shocks on University Operations* 9 (Nat'l Bureau of Econ. Research, Working Paper No. 15861, 2010), *available at* http://www.nber.org/papers/w15861. The study also found that "endowments deviate from their stated payout policy during bad times, *reducing* payout rates. . . ." *Id.* at 5.

[98] This scrutiny has centered on the sector's marketing practices and its students' default rates on federal loans, among other concerns. *See, e.g.*, U.S. Gov't Accountability Office, GAO-10-948T, Testimony Before the Committee on Health, Education, Labor, and Pensions, U.S. Senate, For-Profit Colleges: Undercover Testing Finds Colleges Encouraged Fraud and Engaged in Deceptive and Questionable Marketing Practices (2010), *available at* http://www.gao.gov/products/GAO-10-948T (statement of Gregory D. Kutz, Managing Director, Forensics Audits and Special Investigations); Goldie Blumenstyk, *At Closed-Door Summit, For-Profit Colleges Discuss How to Make the Sector More Accountable*, Chron. Higher Educ. (D.C.) (Feb. 10, 2011), http://chronicle.com/article/At-Closed-Door-Summit/126331; Kevin Kiley, *Report Faults For-Profit Colleges as Providers of 'Subprime Opportunity'*, Chron. Higher Educ. (D.C.) (Nov. 23, 2010), http://chronicle.com/article/Report-Faults-For-Profit/125486.

[99] *See, e.g.*, Sara Hebel et al., *Elections Complicate Colleges' Concerns*, Chron. Higher Educ. (D.C.), Nov. 12, 2010, at A17 (suggesting that a new majority in Congress "might turn up the heat on nonprofit colleges, expanding the Democrats' inquiry into the for-profit sector"); Peter F. Lake, *What's Next for Private Universities? Accountability*, Chron. Higher Educ. (D.C.), Dec. 12, 2010, at A28 ("Congress has just regulated for-profit colleges as never before; most observers believe that even more regulation—this time of private nonprofit higher education—is coming.").

[100] Hebel et al., *supra* note 99, at A17 (suggesting that a new Congress is likely to "look at problems that pervade higher education, including hyperinflationary tuition growth and mounting student debt").

A. Why the Arguments of Payout Proponents Are Unpersuasive

1. No Improvement in Affordability Across the Higher Education Sector

Contrary to the stated purposes of payout advocates (discussed *supra* at Part II.D), a distribution requirement will not improve affordability across the higher education sector. Wealthy universities are the exception, not the norm: they represent a tiny fraction of the institutions in the country and educate a tiny fraction of the country's students.[101] Of 4,391 colleges and universities in the United States,[102] only 128, or 2.9%, have endowments of $500 million or more.[103]

Although one economist has suggested that forcing the wealthiest schools to hold down their tuition might have a "cascading" effect on tuition increases nationwide,[104] others disagree.[105] A "cascading" effect may not take place because less wealthy institutions, which are more dependent on tuition, would not be able to support a reduction in tuition of the magnitude implemented by the wealthiest universities.[106] Over time, this could lead less wealthy institutions to abandon their attempt to compete with the wealthiest universities on tuition discounting, with the result that their tuitions would continue to rise. Thus, even if a payout requirement were to improve affordability at the wealthiest schools—which, as discussed *infra* at Part

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[101] Burton Weisbrod, Evelyn Asch & Jeffrey Ballou, *Don't Mandate Minimum Payout Rates*, THIS SIDE OF THE POND—THE BLOG OF CAMBRIDGE UNIVERSITY PRESS, NORTH AMERICA (Sept. 9, 2008), http://www.cambridgeblog.org/2008/09/do-universities-spend-enough-of-their-endowments ("[T]argeting large endowments could affect at most a small percentage of undergraduates: the overwhelming majority attend schools with endowments under $500 million.").

[102] Chron. of Higher Educ., *2005 Carnegie Classification of Institutions of Higher Education by Classification Category and Control*, ALMANAC OF HIGHER EDUC. 2010 (2010), http://chronicle.com/article/2005-Carnegie-Classification/123998 (subscription required for access).

[103] NACUBO, *supra* note 14, at 5.

[104] *Offshore Tax Issues*, *supra* note 36, at 32 (testimony of Jane Gravelle) ("[Y]ou would expect the compression of tuition at the top would force the other schools to lower their tuition. . . . Just as there is probably a pulling up effect from competing to raise tuition, there should probably be a cascading effect down. So you would expect tuition all along the line to begin to fall a little bit.").

[105] Frances R. Hill, *University Endowments: A (Surprisingly) Elusive Concept*, 44 NEW ENG. L. REV. 581, 597 (2010) ("Proposals for mandatory distributions from endowments do not seem likely to address the high cost of access to higher education or the high costs of operating colleges and universities.").

[106] *See* Richard Vedder, *Department of Token Gestures: It's a Start Yale. Now Do Something Serious*, WASH. POST, Jan. 20, 2008, at B3.

> It's clear that the new financial aid plans offered by Harvard and Yale will put even more pressure on similarly ranked schools . . . to match them. Some of these schools have healthy endowments and are well-positioned to do so, while others might not be able to keep up in the financial aid arms race.

Id.; *see also* Arenson, *supra* note 3.

III.A.2, is questionable—it is uncertain whether the payout would have a larger systemic impact.[107]

2. *Wealthy Universities' Generous Financial Aid*

Critics and lawmakers have focused on how a minimum distribution requirement could benefit low- and middle-income families by combating tuition increases.[108] However, premising a new payout requirement on these grounds is problematic, not only because a payout will fail to increase affordability across the field of higher education, but also because any payout requirement would target precisely those "wealthy" institutions that raise tuition at a slower rate than other schools[109] and that offer some of the most robust financial aid programs.[110]

Low- and middle-income families receive generous support at the wealthiest institutions: students from families with incomes of $60,000 or less often receive full tuition, room, and board; and even families making six-figure incomes receive robust aid packages.[111] At Princeton, for example, the average financial aid award for freshmen in 2008 was greater than $33,450 and covered more than ninety-seven percent of overall tuition.[112] In

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[107] Miller, *supra* note 54, at 5 ("Using the payout ratios to deal with the overwhelming problems in financing higher education would be totally ineffective."). Similarly, Vedder notes, with a critical eye toward the higher education sector, that "increasing financial aid alone [through a payout] won't deal with the fundamental problems of a costly and relatively inefficient higher education system." Vedder, *supra* note 106, at B3.

[108] *See, e.g.*, *Offshore Tax Issues*, *supra* note 36, at 22, 31–32; Karen W. Arenson, *Senate Looking at Endowments as Tuition Rises*, N.Y. TIMES, Jan. 25, 2008, at A1; Grassley, *supra* note 2; Gravelle Memorandum, *supra* note 40, at 2 ("These numbers suggest that small additions from the endowment distribution could mitigate or eliminate tuition growth and substantially expand student aid for many of the institutions in the sample.").

[109] *Myths About College and University Endowments*, ASS'N OF AM. UNIVS. 2 (Jan. 26, 2009), http://www.aau.edu/WorkArea/DownloadAsset.aspx?id=7792 [hereinafter AAU Myths]. For more on tuition increases, see *Should Colleges Be Required to Spend More From Their Endowments?*, CHRON. HIGHER EDUC. (D.C.), Mar. 14, 2008, at A33 (statement of Terry W. Hartle, Senior Vice President for Government & Public Affairs, American Council on Education) (explaining that she has found that many of the wealthiest universities are not the institutions increasing tuition the most) [hereinafter Hartle Remarks]. In its annual *Trends in College Pricing* report on tuition, *supra* note 3, the College Board does not distinguish between tuition increases at institutions by endowment size.

[110] AAU Myths, *supra* note 109, at 2.

[111] *Id.* (listing some of the institutions that "mak[e] college free for . . . low- and moderate-income students"). At Cornell, for example, there is no parent contribution for students from families "with a total family income of less than $60,000, and total assets of less than $100,000," and students from families with a total income under $75,000 receive aid packages with no student loans. *Aid Initiatives*, CORNELL U. OFF. OF FIN. AID & STUDENT EMP., http://www.finaid.cornell.edu (last visited Apr. 2, 2011). Other institutions offer even more generous packages. For example, families with an income of $60,000 or less receive full financial support at Princeton, including tuition, room and board. *Who Qualifies For Aid?*, PRINCETON U. UNDERGRADUATE ADMISSION, http://www.princeton.edu/admission/financialaid/how_it_works/who_qualifies (last visited Apr. 3, 2011). Even families making $100,000 to $120,000 receive an average grant of $38,750 at Princeton, which covers full tuition and eighteen percent of room and board. *Id.*

[112] Tilghman, *supra* note 10.

2010, the university placed first in a national ranking of institutions whose graduating students had the lowest average debt.[113]

In fact, attendance at many wealthy, private institutions is less expensive than attendance at state institutions. For a family with an income of $60,000 or below, it costs less (including tuition, room, and board) to send a child to Amherst, Bowdoin, Dartmouth, Pomona, Wellesley, or Williams Colleges, to Brown, Columbia, Cornell, Harvard, Northwestern, Princeton, Stanford, or Yale Universities, or to MIT or Caltech, than to the University of California at in-state tuition levels.[114] For families making $80,000, most of these institutions are still less expensive than the University of California.[115] According to the University of California, Berkeley's chancellor, it "cost[s] less for a student from a family with an income of $180,000 to go to Harvard than for a student with a family income of $90,000 to go to Berkeley."[116]

Requiring wealthy universities to spend even more on financial aid by means of a mandatory payout may marginally benefit low- and middle-income students, but, given the generous financial support these students already receive, a payout might have the effect of providing a subsidy only for students not already receiving generous financial aid—that is, only for students from the wealthiest families at the wealthiest universities.[117] Thus, a payout requirement could have precisely the opposite effect as that intended.

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[113] Emily Aronson, *U.S. and International Publications Give Princeton High Marks in Rankings*, NEWS AT PRINCETON (Aug. 17, 2010, 12:01 AM), http://www.princeton.edu/main/news/archive/S28/19/93E39/index.xml. "When adjusted for inflation, the average cost of attending Princeton over the last 10 years has actually declined more than 25 percent." Tilghman, *supra* note 10.

[114] SRIKANTH SIVASHANKARAN & MATTHEW REED, PROJECT ON STUDENT DEBT, COMPARISON AND ANALYSIS OF FINANCIAL AID PLEDGES: HOW MUCH WOULD FAMILIES ACTUALLY HAVE TO PAY? 3 (2008), *available at* http://projectonstudentdebt.org/files/pub/Pledges_Analysis.pdf. The University of California is the only public institution for which net cost of attendance is presented for each $20,000 increment in family income. *Id.*

[115] *Id.* The University of California is less expensive, though not by much (between $267 and $2,089), than Brown, Cornell, Dartmouth, and Wellesley for families making $80,000; the university is far cheaper than Northwestern for families at that level (difference of $6,292). *Id.* Similarly, *U.S. News & World Report* explains that "[t]he vast majority of Harvard students receive college scholarships that bring their average annual expenses down to about $15,000, which is less than many public university students pay." Clark, *supra* note 88.

[116] Arenson, *supra* note 3, at A14.

[117] *See* Richard Posner, *Should Universities Have to Spend 5 Percent of Their Endowmen* [sic] *Annually?*, THE BECKER-POSNER BLOG (Feb. 24, 2008, 6:12 PM), http://www.becker-posner-blog.com/2008/02/should-universities-have-to-spend-5-percent-of-their-endowmen-annually—posner.html. Some critics have called for universities to use a payout to eliminate tuition altogether. *See, e.g.*, VEDDER, *supra* note 40, at 19 ("*Harvard has the means to eliminate all tuition, room and board charges for its students without dissipating its endowment*. Recent initiatives to lower the net tuition rate for many students, while welcome, are modest in relation to the potential indicated by the endowment's size."); *see also* Lynne Munson, *Endowment Reform: Why Universities Should Share Their Vast Wealth and in the Process Make Higher Education More Affordable*, *in* CTR. FOR COLL. AFFORDABILITY & PRODUCTIVITY, UNIVERSITY ENDOWMENT REFORM: A DIALOGUE 11, 12 (2008), *available at* http://www.centerforcollegeaffordability.org/uploads/Miller_Munson_corrected.pdf ("Harvard and Yale are so wealthy that it would take less than 1 percent endowment spending for their students to attend

3. *University Accountability*

Furthermore, a mandatory payout is not necessary to ensure accountability (as proponents often argue), which distinguishes universities from private foundations[118] and removes one of the principal justifications for a payout. Colleges and universities are already accountable to a host of people and organizations that act as watchdogs, policing their use of wealth. This group includes students,[119] prospective students and their parents,[120] faculty and staff,[121] alumni,[122] donors,[123] trustees,[124] accrediting agencies,[125] credit

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tuition-free. Two percent spending would add Stanford, Princeton, MIT, and Rice students to that list."). These calls raise the same issue: eliminating tuition would primarily benefit the wealthy students, since lower and middle-income students already do not pay full (or any) tuition. *See* Posner, *supra* ("Forcing abolition of tuition would be a subsidy for rich kids.").

[118] See *infra* Part III.A.4 for a detailed discussion of foundations.

[119] WEISBROD ET AL., *supra* note 24, at 102 ("A tuition-driven school—relying heavily on that source of revenue—must satisfy tuition-paying students to survive, let alone flourish.").

[120] For example, a college that gives small financial aid packages while letting its endowment wealth accumulate will not be able to compete in the market for prospective students. *See* Cowan, *supra* note 9, at 548. *See generally* EHRENBERG, *supra* note 21, at 78–88 (explaining the competition for prospective students).

[121] Since faculty members are involved in the "shared governance" of colleges and universities, EHRENBERG, *supra* note 21, at 20–23, universities are accountable to their faculty members to some extent. *See* STEVEN G. POSKANZER, HIGHER EDUCATION LAW: THE FACULTY 104–05 (2002). Additionally, an institution that accumulates wealth rather than spending it on faculty and staff salaries will not be able to recruit or retain top faculty and staff. *See generally* EHRENBERG, *supra* note 21, at 115–25 (discussing faculty salaries). As Cowan explains, "an institution that is strategically using its endowment to make investments in student aid or faculty development may be better positioned to attract student and faculty talent." Cowan, *supra* note 9, at 548.

[122] *Offshore Tax Issues*, *supra* note 36, at 165 (statement of David Ward, President, Am. Council on Educ.) (noting that "[t]here are many constituencies that play a role in ensuring that [endowment] dollars are spent for their intended purposes, including . . . alumni"); Cowan, *supra* note 9, at 549 (noting that alumni "will not hesitate to raise their voices to criticize board decisions or to weigh in on important issues of institutional governance or mission").

[123] *Offshore Tax Issues*, *supra* note 36, at 165 (statement of David Ward, President, Am. Council on Educ.) (noting that donors also play a role in policing endowment spending); Cowan, *supra* note 9, at 549 ("Finally, and perhaps most importantly, the higher education community is subject to the scrutiny of donors and potential donors. Colleges and universities, unlike private foundations, must raise money. Despite having large endowments, institutions continue to fundraise, which makes them subject to prospective donor scrutiny."); Hechinger, *supra* note 4.

[124] EHRENBERG, *supra* note 21, at 25; Cowan, *supra* note 9, at 549; AAU Myths, *supra* note 109, at 3. At public institutions, the Board may include appointed trustees who are highly critical of the school. Cowan, *supra* note 9, at 549.

[125] Cowan, *supra* note 9, at 548.

rating agencies,[126] the media,[127] institutions' local communities,[128] state governments,[129] and government agencies like the IRS.[130]

These agents have produced significant change in university financial operations before: for example, the anti-apartheid student movement of the mid-1980s successfully brought about widespread divestment from South Africa at colleges and universities nationwide.[131] Similarly, local municipalities' scrutiny in recent years has led universities to negotiate arrangements whereby the institutions make voluntary payments to their communities.[132]

In sum, if endowment accumulation becomes a problem, there is an argument that these constituencies will hold universities responsible. Universities might lose donations, which are a major source of revenue. They might lose alumni support. They might lose public support.[133] And they could face increasingly skeptical local governments,[134] students, and parents, all clamoring for greater payouts. Congress's intervention—unlike in the case of private foundations—is not necessary here.

4. *The Flawed Comparison to Private Foundation Payouts*

Critics' reliance on the comparison to the private foundation payout scheme, *infra* Part II.D, is problematic and does not support the argument

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[126] Conti-Brown, *supra* note 95, at 43. The author is indebted to Luke Anderson for bringing this point to his attention.

[127] *See supra* Part II; *see also* James J. Fishman & Stephen Schwarz, Nonprofit Organizations: Cases and Materials 7 (4th ed. 2010).

[128] *See supra* note 80 (municipalities proposing tuition taxes and other methods for forcing their local colleges and universities to provide additional funds to the government); *Offshore Tax Issues*, *supra* note 36, at 165 (statement of David Ward, President, Am. Council on Educ.) (noting that the communities surrounding institutions of higher education play a role in policing endowment spending).

[129] An example of state government accountability in recent years is New York State Governor Andrew Cuomo's investigation, when he was state Attorney General, of colleges' arrangements with lenders for student loans. *See* Karin Fischer, *New York Asks 60 Colleges to Explain Ties to Lenders*, Chron. Higher Educ. (D.C.), Feb. 16, 2007, at A32; Jonathan D. Glater, *Cuomo Investigates Colleges and Ties to Student Lenders*, N.Y. Times, Feb. 1, 2007, at B6. Attorney General Cuomo also investigated colleges' arrangements with credit card companies, Paul Basken, *Cuomo's Latest Target: Credit-Card Deals*, Chron. Higher Educ. (D.C.), Mar. 14, 2008, at A15, study abroad programs, Karin Fischer, *Cuomo Expands Investigation of Study-Abroad Programs to Colleges*, Chron. Higher Educ. (D.C.), Feb. 1, 2008, at A25, and health insurance companies, Jonathan D. Glater, *Cuomo Investigates Colleges' Deals with Health Insurers*, N.Y. Times, Nov. 17, 2008, at B3.

[130] *See* Eric Frazier & Eric Kelderman, *IRS Steps Up Scrutiny of Colleges and Other Nonprofit Organizations*, Chron. Higher Educ. (D.C.), Jan. 7, 2011, at A15.

[131] Philip G. Altbach, *American Student Politics: Activism in the Midst of Apathy*, *in* The History of Higher Education 775, 782 (Harold S. Wechsler, Lester F. Goodchild & Linda Eisenmann eds., 2007).

[132] John R. Thelin, A History of American Higher Education 358 (2004); *see also* Kelderman, *supra* note 80.

[133] This is already happening. *See, e.g.*, Eric Kelderman, *Public Opinion of Higher Education Continues Downward Slide*, Chron. Higher Educ. (D.C.) (Feb. 17, 2010), http://chronicle.com/article/Public-Opinion-of-Higher/64217/.

[134] *See supra* note 80 (Pittsburgh and other communities proposing taxes); *supra* note 5 (Boston proposing a tax on endowments over $1 billion).

that university endowments should be subject to a similar payout requirement.

Citing the foundation payout as a model for a university payout presumes that the foundation payout is sound policy. A full evaluation of the foundation distribution requirement is beyond the scope of this Note, but both empirical[135] and anecdotal evidence[136] suggest that the five percent payout has become a ceiling for foundations' spending. This has led some researchers to argue, perhaps counterintuitively, that removing the payout could increase payouts "by forcing the foundations to actually focus on the best distribution policy to pursue their mission."[137] Senator Grassley has expressed the concern that imposing a five percent payout on endowments might similarly encourage universities not to spend at higher levels.[138] Critics must address these issues before they can make a convincing argument for a payout for endowments.

Even assuming the soundness of the foundation payout policy, analogizing from the private foundation context to the university context is inapt. Universities are comparable not to private foundations but to operating foundations, which are a special type of foundation expressly not required to spend five percent each year.[139] An operating foundation spends its funds "directly for the active conduct of activities constituting its charitable, educational, or other similar exempt purpose."[140] Thus, instead of only making grants, these foundations primarily use their resources to run their own projects, such as research programs or library facilities.[141] Operating foundations maintain staffs, buildings, collections, and research labs,[142] and thus have ongoing financial commitments (unlike grant-making foundations).[143] It is due to these commitments that operating foundations are not required to

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[135] Daniel Halperin, *Tax Policy and Endowments—Is Excessive Accumulation Subsidized?*, 67 EXEMPT ORG. TAX REV. 125, 128 (2011) (citing research by Akash Deep and Peter Frumkin).

[136] Stephanie Strom, *How Long Should Gifts Just Grow*, N.Y. TIMES, Nov. 12, 2007, at H1 ("These 'spend it sooner' proponents say that the minimum that private foundations are required to give—5 percent of their assets each year—has in many cases become the maximum."). Commenting on this phenomenon, Warren Buffett said that if the mandatory foundation payout were lowered to three percent, he is "sure many foundations would quickly adjust their spending downwards." *Id.*

[137] Halperin, *supra* note 135, at 128.

[138] Blumenstyk, *supra* note 48.

[139] I.R.C. § 4942(a)(1) (2006).

[140] Treas. Reg. § 53.4942(b)-1 (as amended in 1983). For the complete listing of exempt purposes, see I.R.C. § 501(c)(3) (2006). *See also* I.R.C. § 4942(j)(3) (2006); HOPKINS & BLAZEK, *supra* note 68, at § 3.1, 107 (explaining that operating foundations "devote most of their earnings and much of their assets directly to the conduct of their tax-exempt purposes").

[141] HOPKINS & BLAZEK, *supra* note 68, at § 3.1, 108; I.R.S., EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION, PRIVATE OPERATING FOUNDATIONS (1984), *available at* http://www.irs.gov/pub/irs-tege/eotopicn84.pdf ("Examples of operating foundations include museums, zoos, research facilities, libraries, etc.").

[142] HOPKINS & BLAZEK, *supra* note 68, at § 3.1, 109.

[143] Cowan, *supra* note 9, at 548.

meet the higher payouts imposed on private foundations,[144] and instead must make annual payments of 4.25% or lower.[145]

Colleges and universities likewise have ongoing commitments,[146] and should similarly be exempted from the higher private foundation payout rate. Like operating foundations, colleges and universities do not have the flexibility that grant-making foundations have to reduce grants in a given year in response to economic cycles and still maintain payout obligations.[147]

One scholar explains that "[i]t would seem quite odd for Congress to exempt operating foundations and yet impose the minimum distribution requirements on colleges and universities."[148] More than "odd," it would be fundamentally inconsistent. Whereas a university with a $1 billion endowment would be subject to a five percent payout, an operating foundation with the same endowment would be subject to a far lower payout requirement—even, presumably, if it operated a quasi-university complete with tenured faculty.[149]

Senator Grassley addressed this concern briefly in a 2010 press release, in which he suggested that payout requirements might be made consistent across "[o]ther types of asset-accumulating charities—such as endowments, donor-advised funds, and certain supporting organizations."[150] Legislation that imposed payout requirements on all "asset-accumulating charities" might resolve the inconsistency, if it also encompassed operating founda-

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[144] Halperin, *supra* note 135, at 127 (citing S. Rep. No. 91-552, at 2064, 2088–89 (1969)) ("Presumably on the belief that organizations that carry out charitable activities directly need more flexibility than grant-making institutions, Congress reduced the distribution requirement for so-called operating foundations to as little as 3.33 percent of investment assets . . . .").

[145] *Id.*; Hopkins & Blazek, *supra* note 68, at § 3.1, 115, 118–19. Operating foundations must spend an individualized amount calculated under a "dual system" that tests both the foundation's income levels and its assets. I.R.C. § 4942(j)(3)(B) (2006); Treas. Reg. § 53.4942(b)-1 (as amended in 1983); Hopkins & Blazek, *supra* note 68, at § 3.1, 108. The payout amount can be as low as 3.33% of the foundation's assets. Halperin, *supra* note 135, at 127.

[146] *See, e.g.*, Ehrenberg, *supra* note 21, at 70–75 (section on "[t]he costs of recruiting and enrolling students"); *id.* at 113–25 (faculty salaries); *id.* at 146–53 (the cost of maintaining physical facilities).

[147] Tilghman, *supra* note 10; AAU Myths, *supra* note 109, at 4 ("[U]niversity endowments fund ongoing programs, while private foundations typically do not run operations but make grants to external parties. This gives foundations flexibility to adjust the size of grants year by year to meet their payout requirements. Universities do not have this kind of flexibility."); *see also* Ehrenberg, *supra* note 21, at 42.

[148] Cowan, *supra* note 9, at 545.

[149] As an example, the Field Museum, though not an operating foundation, exhibits several "quasi-university" characteristics: the museum is home to major research collections, a research staff of 150 (divided into four academic departments), and considerable laboratory facilities; the museum sponsors visiting scholars and researchers; and the museum even has a tenure system. *See* Field Museum, Field Museum 2008 Annual Report (2009), *available at* http://archive.fieldmuseum.org/annualreport08/collections.html; *Positions Open*, 7 SAA Archaeological Rec. 51, 51 (2007) (advertisement "for a tenure-track position as Assistant Curator of Anthropology").

[150] Press Release, Senator Charles Grassley, Grassley: Students, Families Shouldn't Bear Brunt of College Endowment Losses (Jan. 27, 2010), *available at* http://finance.senate.gov/newsroom/ranking/release/?id=71a9e9f3-9110-4bda-84e4-c473169e1bdc.

tions.[151] However, such legislation would only extend to all nonprofit organizations the adverse effects that colleges and universities would experience under a payout regime. To take but one example, the Getty Museum might find itself required to spend millions of dollars more each year than it otherwise would. This could impact art museums around the country: the Getty could be forced to dominate the art market, while smaller museums would suffer by being priced out of a market that would become more expensive due to increased competition with the Getty.[152] The problems that can be anticipated in the higher education context would simply be replicated in other contexts.

Another major problem with comparing a university endowment payout requirement with the private foundation payout requirement is that such regulations have different goals. The foundation payout requirement, like other foundation regulations, addresses foundations' lack of accountability: the "provisions reflect concerns that private foundations were operating for the benefit of the contributors who control them" and not in furtherance of the charitable purposes for which they were established.[153] Foundations could get away with spending little or no money, hence the need for a payout requirement.[154] Universities, however, are not lacking in accountability, as discussed *supra* at Part III.A.3, and further, they cannot operate without spending money.

B. Harmful Consequences of a Mandatory Payout

1. Accelerating the Arms Race

Requiring a five percent payout could have "the unintended consequence of accelerating the academic arms race."[155] The term "arms race" in the academic context typically refers to the competition between schools to attract the top students by providing the best educational opportunities—as well as the best dormitories, dining halls, and athletic facilities[156] (although

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[151] However, a payout impacting operating foundations would need to be designed so that it would not require operating foundations to "spend" non-investment assets that they accumulate in furtherance of their charitable purposes; for example, artwork for the Getty Museum.

[152] *See, e.g.*, Douglas C. McGill, *Getty, the Art World's Big Spender*, N.Y. TIMES, Mar. 4, 1987, at C23 (explaining that even conservative estimates of the Getty's acquisition budget at the time "far exceed[ ] the acquisition budget of any other museum in the United States" and that the Getty's purchases of particular types of artwork were substantially driving up the prices in those markets). Such concerns would only be exaggerated by a required payout. The author thanks Professor Bruce Mann for highlighting this example.

[153] Hill, *supra* note 105, at 598; *see also* Cowan, *supra* note 9, at 546–47; Waldeck, *supra* note 9, at 1814.

[154] Cowan, *supra* note 9, at 547.

[155] VEDDER, *supra* note 40, at 20.

[156] EHRENBERG, *supra* note 21, at 14; Waldeck, *supra* note 9, at 1815–16; *see also* Anthony Bianco & Sonal Rupani, *The Dangerous Wealth of the Ivy League*, BUS. WK., Dec. 10, 2007, at 38 (describing Princeton's luxurious new residence halls and Stanford's renovation of its equestrian center, among other "lavish" expenses); *Just Add Cash: The Great Expanding*

some have also used the term more generally to explain the competition for top faculty and, in the end, for prestige).[157]

If Congress were to impose a payout requirement, the wealthy universities subject to it would need to spend more annually—millions of dollars more. Where would this money go? If Congress did not mandate that such funds be used specifically for student aid, the wealthy universities would surely use some of their funds to reduce their class sizes and offer more amenities to their students.[158] Richard Vedder, a prominent higher education economist (and vocal critic of universities' current financial practices),[159] argues that the increased non-academic spending would trickle down to other universities.[160] This leads him to conclude that a payout would not reduce costs for students and potentially could be "part of the problem, not the solution,"[161] by contributing to rising tuition (which would be necessary to finance the amenities).[162]

It is important to note that these extra expenditures would presumably "benefit" wealthy institutions in the short-term, since the spending would lead to smaller classes, more amenities to better compete for the best students, and so on. Nevertheless, additional expenditures for wealthy universities in the present would mean less money would be available to those

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American University, THE ECONOMIST, Nov. 29, 2007, at 42 (criticizing recent university construction projects and discussing several Texas institutions' attempts to outdo one another to build the highest climbing wall).

[157] *Just Add Cash*, *supra* note 156. For more on the "arms race" in faculty hiring, see EHRENBERG, *supra* note 21, at 113, 122–25; Bianco & Rupani, *supra* note 156, at 38 ("Even the most prestigious of public universities are increasingly hard-pressed to repulse richly financed Ivy Plus raiding sorties seeking to steal distinguished faculty members and their research grants."); Audrey Williams June, *Public Colleges Fight Raids on Faculties*, CHRON. HIGHER EDUC. (D.C.), Aug. 15, 2008, at A1 (discussing the "brain drain" of the best faculty members from less prosperous institutions to more prosperous ones). For examples of even well-endowed public institutions facing stiff competition, see Arenson, *supra* note 3; Brian K. Sullivan & Matthew Keenan, *Berkeley Raises $1.1 Billion to Keep Professors From Ivy League*, BLOOMBERG.COM (Mar. 14, 2008, 12:01 AM), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=apfnctfiPQPk ("Berkeley's teachers now often earn less than counterparts at Harvard University, may soon be underpaid by 30 percent, and are vulnerable to higher offers . . . ."). Students, faculty, buildings, and prestige tie into one another, as well: "New and better lab space, meanwhile, can draw star scientists, research-grant money and revenue from patents that result from that research. All of that—along with, preferably, a new stem-cell lab that can be used in promotional tours—in turn attracts more top applicants." Arenson, *supra* note 3.

[158] VEDDER, *supra* note 40, at 20.

[159] *See, e.g.*, RICHARD VEDDER, GOING BROKE BY DEGREE: WHY COLLEGE COSTS TOO MUCH (2004).

[160]
> Higher endowment spending at the top very well could induce the second tier of private universities and the selective public institutions to increase non-academic spending on amenities that have little to do with advancing instruction or the frontiers of knowledge. If you force Harvard to spend more, ultimately it will impact even the Slippery Rock colleges of the world.

VEDDER, *supra* note 40, at 20.

[161] *Id.*

[162] *See* Goldie Blumenstyk, *Colleges' Endowment-Spending Prerogatives Get Unexpected Defense*, CHRON. HIGHER EDUC. (D.C.) (Feb. 4, 2008), http://chronicle.com/article/Colleges-Endowment-Spending/467.

universities (and their students) in the long run,[163] not to mention the systemic increase in tuition that Vedder notes.

Turning to student aid, some of universities' extra payout would likely support financial aid, regardless of whether or not Congress required the money to be so spent. At first glance, this would help students. However, not all or even most of the aid would necessarily go to needy students. Indeed, "[i]n an increasingly competitive marketplace, any new financial aid might flow to wealthier students as merit aid,"[164] because this allocation would help institutions attract top students, both from their competitors and from more prestigious schools.[165] Thus, increased spending on financial aid—whether required or discretionary—caused by a mandatory payout might not improve affordability at "wealthy" schools for the students who would most benefit from such a reduction in out-of-pocket tuition.

More problematically, the increased aid at wealthy schools could have a trickle-down effect. With wealthier institutions spending more on merit aid and awarding larger aid packages as a result of a mandatory payout, less wealthy institutions might be incentivized to increase their merit aid to attract top students.[166] And for these less wealthy institutions, increases in merit aid would necessarily come at the expense of need-based aid.[167]

Finally, Congress could take the further step of requiring that the funds from an increased payout go to need-based financial aid specifically. This could hamper the talent-recruiting abilities of universities that use merit aid; although, presumably, these institutions could just reallocate the funds they were already spending on need-based aid for merit aid. A condition of this sort, if tailored appropriately, might avoid accelerating the arms race—though it would approach an unprecedented level of intrusiveness into college and university affairs.

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[163] *See infra* Part III.B.4.

[164] Weisbrod et al., *supra* note 101. "Merit aid," or merit-based aid, is institutional grant aid awarded for academic performance and not based on financial need ("need-based aid"). EHRENBERG, *supra* note 21, at 86. Merit aid tends to go to wealthier students. EHRENBERG, *supra* note 21, at ix; MICHAEL S. MCPHERSON & MORTON OWEN SCHAPIRO, THE STUDENT AID GAME: MEETING NEED AND REWARDING TALENT IN AMERICAN HIGHER EDUCATION 111 (1998). Since the wealthiest handful of institutions already meet the "full need" of all accepted students, EHRENBERG, *supra* note 21, at 75, this concern about increased payout money going to merit aid should not concern their student bodies or prospective students. However, increases in merit aid likely would appear at the more than one hundred other institutions with endowments in excess of $500 million that would be subject to a mandatory payout.

[165] *See generally* MCPHERSON & SCHAPIRO, *supra* note 164, at 110 (explaining the use of merit aid "by schools of lesser reputation or quality to 'buy' students from more prestigious schools" and "among schools of roughly equal quality or reputation for the most meritorious students in the schools' combined applicant pool").

[166] *See, e.g.*, EHRENBERG, *supra* note 21, at 86 ("Selective institutions, such as Cornell, found that they were increasingly losing top students [in the 1990s] not only to better-endowed selective private institutions that practiced need-based financial aid, but also to lesser private and public institutions that were explicitly providing merit awards that were unrelated to need."); Weisbrod et al., *supra* note 101.

[167] *See* EHRENBERG, *supra* note 21, at 88 ("With a fixed financial aid budget, dollars for still further increases in merit aid will come at the expense of dollars for need-based aid.").

2. *Constraining Universities' Ability to Respond to Economic Fluctuations*

A minimum distribution requirement would harm universities' ability to respond to market fluctuations.[168] Since universities cannot simply close academic departments in a bad economy (unlike private foundations, which can reduce their grant-making in dollar terms),[169] they must be able to "save during flush times and spend more in hard economic times."[170] This allows for continuity in support for academic programs and financial aid, without which universities would be highly susceptible to every market change.[171]

The loss in flexibility that a five percent payout would cause could perhaps be ameliorated, though not removed altogether, if the payout rate were tailored to allow some elasticity in bad economic climates. For example, if the rate were "capped" so that it never exceeded investment returns or if it were based on a rolling average over several years,[172] the effect would presumably be less drastic than the effect of a flat five percent requirement. Nevertheless, even a tailored payout might fetter institutions' abilities to respond to downturns or to strategically plan for ambitious projects or initiatives.[173]

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[168] *See, e.g.*, *Offshore Tax Issues*, *supra* note 36, at 165 (statement of David Ward, President, Am. Council on Educ.); Tilghman, *supra* note 10; Michael McDonald & John Lauerman, *IRS Survey Shows Schools Hoard Funds, Grassley Says*, BLOOMBERG BUSINESSWEEK (May 14, 2010, 5:30 PM), http://www.businessweek.com/news/2010-05-14/irs-survey-shows-schools-hoard-funds-grassley-says-update1-.html (quoting an attorney stating that a mandatory payout "would remove flexibility and creativity from the tools available to colleges").

[169] AAU Myths, *supra* note 109, at 4.

[170] Field, *Lawmakers Ease Pressure for Mandatory Payouts as Colleges Increase Aid*, *supra* note 36 (summarizing the flexibility argument that several college representatives made at the fall 2008 roundtable discussion on university endowments).

[171] *See* Halperin, *supra* note 135, at 127 (discussing the importance of flexibility for public charities). Ehrenberg provides a straightforward explanation of how economic fluctuations would impact a university that utilized a constant payout:

> If [universities] spent a constant fraction of their endowment value [as would happen under a mandatory payout] and the endowment went up in value by 20 percent one year and then fell in value by 20 percent the next year, they would see their spending from the endowment first increase, and then decrease, by 20 percent. Such wide fluctuations in spending do not make sense for an academic institution, because it would have to scramble to find funds to make up for the loss of funding from the endowment in the second year.

EHRENBERG, *supra* note 21, at 42.

[172] *See supra* note 57.

[173] See, for example, EHRENBERG, *supra* note 21, at 104–06 for a case study of a university engaging in capital planning for the construction of a major new research facility. The university needed to raise substantial funds from donors, and additionally, it needed to plan ahead for the significant costs of operating and maintaining the building, much of which would have to come from the university's annual operating budget. *Id.* at 106.

3. *Risking American Higher Education's International Strength*

American universities have enjoyed unparalleled international recognition and are, by many experts' estimations, the "envy" of the world.[174] Even after acknowledging the criticisms of international ranking schemes,[175] it is hard not to notice the overwhelming dominance in these measures of American universities, which claimed between thirteen and seventeen of the top twenty spots in the various 2010 rankings.[176]

Some commentators see endowments as having played a significant role in securing American universities' preeminence.[177] Extending this conclusion, others have questioned whether a payout requirement might damage American institutions' international stature.[178] This is especially relevant in

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[174] CHARLES M. VEST, PURSUING THE ENDLESS FRONTIER: ESSAYS ON MIT AND THE ROLE OF RESEARCH UNIVERSITIES 259 (2005). Henry Rosovsky, the distinguished former Dean of Harvard's Faculty of Arts and Sciences, wrote the following in 1987, which rings true today, as well (as attested to by Vest's quotation, above): "In these days when foreign economic rivals seem to be surpassing us in one field after another, it may be reassuring to know that there is one vital industry where America unquestionably dominates the world: higher education." Henry Rosovsky, *Highest Education*, NEW REPUBLIC, July 13, 1987, at 13, *reprinted in* AMERICAN HIGHER EDUCATION 63 (Wilson Smith & Thomas Bender eds., 2008). For a contrary take on the primacy of American higher education as a whole, but agreement on the standing of elite institutions, see Robert Zemsky, *Accountability in the United States: Sorting Through an American Muddle*, *in* ACCOUNTABILITY IN HIGHER EDUCATION: GLOBAL PERSPECTIVES ON TRUST AND POWER 157, 158 (Bjorn Stensaker & Lee Harvey eds., 2010) ("Where once American colleges and universities had been the envy of the world, now only a handful of élite, mostly private institutions can lay claim to that mantle.").

[175] *See, e.g.*, Aisha Labi, *Obsession with Rankings Goes Global*, CHRON. HIGHER EDUC. (D.C.), Oct. 17, 2008, at A27 (describing critics' arguments that the Academic Rankings of World Universities, produced by Shanghai Jiao Tong University, is "putting too much emphasis on scientific research" and that the U.K.'s *Times Higher Education* list puts too much emphasis "on the opinions of people at peer institutions"). French critics claim the rankings are biased towards English-speaking institutions. *Id.*

[176] U.S. institutions claimed seventeen of the top twenty spots in the 2010 Academic Rankings of World Universities ("ARWU"), fifteen of the top twenty spots in the 2010 *Times Higher Education* World University Rankings, and thirteen of the top twenty spots in *U.S. News & World Report*'s World's Best Universities for 2010. *See Academic Ranking of World Universities—2010*, ACAD. RANKINGS OF WORLD U., http://www.arwu.org/ARWU2010.jsp (last visited Jan. 14, 2011); *World's Best Universities: Top 400*, U.S. NEWS & WORLD REP. (Feb. 25, 2010), http://www.usnews.com/education/worlds-best-universities/articles/2010/09/21/worlds-best-universities-top-400; *The World University Rankings 2010*, TIMES HIGHER EDUC., http://www.timeshighereducation.co.uk/world-university-rankings/2010-2011/top-200.html (last visited Jan. 14, 2011).

[177] *See, e.g.*, Robert Winnett, *Blair Wants US-Style University Endowments*, SUNDAY TIMES (London), Jan. 7, 2007, at 5.

[178] Marx, *supra* note 10 ("[W]hatever steps are taken [by Congress] should not compromise the excellence of the nation's higher education system, perhaps the one industry sector remaining in which the United States remains the global leader."). Tilghman provides a similar sentiment:

> I do not believe that government mandated spending policies would serve these institutions, their students or the country well, especially at a time when our country is more dependent than ever on its colleges and universities to provide the ideas and prepare the leaders who will sustain our global competitiveness in an increasingly knowledge-based world.

light of the fact that other countries are pushing to improve in the rankings,[179] and their universities are seeking to build larger endowments modeled on the American approach.[180] Oxford, for example, launched a $2 billion fundraising campaign in 2004 and has, along with other top British institutions, led the way in adopting American endowment-managing methods.[181] A United Kingdom parliamentary report from 2003 called for "a much greater role for universities establishing endowment funds" following the model of the United States.[182] Former Prime Minister Tony Blair explained in 2007 that endowments are "critical to the way American universities have succeeded" and that he was "looking now at how we get a similar endowment system going" in Great Britain.[183]

Another British report observed that American universities built most of their wealth in the short span of twenty years.[184] This suggests just how quickly the universities of other countries might overtake American institutions in resources—and in competition for top faculty and international students,[185] research prowess, new inventions, and global impact—especially if Congress were to hamper flexibility and endowment growth through regulation.

Tilghman, *supra* note 10.

[179] *See, e.g.*, Labi, *supra* note 175; Martha Ann Overland, *University's Slide in Global Rankings Draws Rebuke from Malaysia's Leader*, CHRON. HIGHER EDUC. (D.C.), Nov. 25, 2005, at A46 ("In response to the slide, Malaysia's higher-education minister, Shafie Mohd Salleh, announced he would convene a committee to see how the country's public universities can raise their international standing."); Aisha Labi, *University Mergers Sweep Across Europe: Leaders Hope Larger, More-Diverse Institutions Will Improve Research*, CHRON. HIGHER EDUC. (D.C.) (Jan. 2, 2011), http://chronicle.com/article/University-Mergers-Sweep/125781 ("Nicolas Sarkozy . . . has taken France's relatively poor showing on the best-known rankings to heart and has spoken repeatedly of his goal of having two French universities in the top 20 and 10 in the top 100 of the world rankings.").

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> Partly in response to decades of "brain drain" to the United States and partly prompted by increased competition from universities in the emerging economies of India and East Asia, *European universities are increasingly turning to American-style fund-raising methods in an effort to amass endowments that would in turn give them greater economic independence and stability*.

D. D. Guttenplan, *In Europe, Fund-Raising Lessons from Americans*, N.Y. TIMES, Sept. 5, 2010 (emphasis added), *available at* http://www.nytimes.com/2010/09/06/business/global/06iht-educ.html.

[181] *Id.*

[182] HOUSE OF COMMONS EDUCATION AND SKILLS COMMITTEE, H.C. 425-I, THE FUTURE OF HIGHER EDUCATION, FIFTH REPORT OF SESSION 2002–03, at 19, *available at* http://www.publications.parliament.uk/pa/cm200203/cmselect/cmeduski/425/425.pdf.

[183] Winnett, *supra* note 177.

[184] THE SUTTON TRUST, UNIVERSITY ENDOWMENTS—A UK/US COMPARISON 5 (2003), *available at* http://www.suttontrust.com/research/university-endowments-a-usuk-comparison/.

[185] There is already heated competition for international students, both at the undergraduate level and in professional programs. *See, e.g.*, Katherine Mangan, *Global Focus Draws Students to Europe for Business*, CHRON. HIGHER EDUC. (D.C.), Oct. 1, 2010, at A1; Stu Woo, *Competition Increases for Foreign Students*, CHRON. HIGHER EDUC. (D.C.), Oct. 27, 2006, at A43.

4. *Reduced University Spending*

Although counterintuitive, a lower payout rate actually provides *more* funding for universities in the long term,[186] again suggesting that a mandatory payout should not be imposed. Take two endowments of equal size and consider their payouts over an extended period of time, with 3.5% annual spending from one endowment and five percent annual spending from the other. Assume ten percent annual returns. As one might expect, the endowment with a five percent spending rate pays out more—initially. However, the endowment with a 3.5% spending rate grows its principal at a faster pace because it does not pay out as much each year. As a result, after just twenty-four years, the endowment with the 3.5% spending rate in fact pays out more in actual dollars than does the endowment with the five percent spending rate.[187] After thirty-nine years, the endowment with the 3.5% spending rate will in fact have paid out more in total, in today's dollars, than the endowment with the five percent spending rate.[188]

Charles Miller similarly observes that a $100 million endowment will pay out more over a forty year period with an annual payout rate of four percent than with a payout rate of five percent.[189] He explains that "[f]iduciaries have a duty to understand and make decisions on these kinds of [long-term] outcomes."[190]

This exercise could be continued ad infinitum: after a certain amount of time, even an endowment with a one percent spending rate would pay out more per year, and eventually more in sum, than an endowment with a five percent spending rate.[191] Yet few would endorse a one percent spending rate. The critical point, however, is that in the space of a short period of time—*less than forty years*—an endowment with a lower spending rate will pay out more, both annually and in sum, adjusted for inflation, than will an endowment with a five percent payout rate. This offers another factor to be considered when looking at possible regulations of university endowments.[192]

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[186] Miller, *supra* note 54, at 7; Univ. of Va., *Comparison of Long-Term Endowment Growth Under Different Payout Rates*, ASS'N OF AM. U. (Nov. 1, 2007), http://www.aau.edu/WorkArea/DownloadAsset.aspx?id=2764.

[187] Author's calculations (on file with Harvard Journal on Legislation).

[188] *Id.* The author is grateful to Luke Anderson for helpful feedback regarding these figures.

[189] Miller, *supra* note 54, at 7.

[190] *Id.*

[191] As Professor Daniel Halperin notes, "Carried to an extreme it would suggest no distributions would maximize total distributions which is obviously ridiculous." E-mail from Daniel Halperin, Stanley S. Surrey Professor of Law, Harvard Law Sch., to Author (Feb. 1, 2011, 12:06 PM EST) (on file with Harvard Journal on Legislation).

[192] One might argue that the goal of payout proponents may be to increase student aid and affordability in the short term, regardless of the financial impact in forty years. This is an interesting argument that pits the needs of the current generation of students against the needs of the next generation of students—the classic question of intergenerational equity. Much has been written on this topic. *See, e.g.*, Cowan, *supra* note 9, at 526–27; Hansmann, *supra* note 9,

5. *Other Negative Consequences*

The aforementioned possibilities are not the only potential negative consequences of a mandatory payout rate. Senator Grassley himself has expressed concern that a minimum distribution requirement intended to act as a floor for spending might become, in effect, a ceiling, with institutions opting never to spend at a higher rate.[193] This phenomenon has been observed in foundations[194] and should give lawmakers pause before instituting a similar measure for university endowments.

Furthermore, one economist has suggested that "mandated minimum payouts may lead to creative accounting that renames assets something other than 'endowment' so as to exclude them from payout regulation," resulting in lower overall payouts than exist at present.[195] This suggests that additional work would need to be invested in monitoring spending rates once they had been subjected to legislation.

Some commentators have noted that a minimum distribution requirement of five percent would tend to undercut the spending practices endorsed by the Uniform Prudent Management of Institutions Funds Act ("UPMIFA"), which governs investment expenditures at charitable institutions in forty-seven states.[196] In its prefatory note, UPMIFA states that spending six percent of an institution's endowment assets "might well be imprudently high."[197] This admonition is noteworthy, though admittedly less forceful, if a payout were set at five percent. However, some commentators have argued that a payout requirement could be even higher than five percent, in which case the warnings of an influential uniform act would have to be reconciled with Congress's goals before any legislation could proceed.

Finally, a concern related to creative accounting is that a mandatory payout might incentivize universities simply to raise more for current operating costs. That is, "[i]f schools are compelled to spend money that they

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at 14–18. And there are ample criticisms of whether universities should even be in the business of transferring wealth when their "chief mission" is education and research. Hansmann, *supra* note 9, at 18. However, intergenerational equity concerns may have some weight in this instance, since not only can we determine that the current generation's children and grandchildren will have greater resources at their disposal (including but not limited to financial aid) if a more modest payout rate is adopted, but we can quantify precisely *how much more* the next generation will have.

[193] Blumenstyk, *supra* note 48.

[194] *Infra* Part III.A.4.

[195] Weisbrod et al., *supra* note 101.

[196] Johnny Rex Buckles, *Should the Private Foundation Excise Tax on Failure to Distribute Income Generally Apply to 'Private Foundation Substitutes'? Evaluating the Taxation of Various Models of Charitable Entities*, 44 New Eng. L. Rev. 493, 531 (2010); Verne O. Sedlacek & William F. Jarvis, *Endowment Spending: Building a Stronger Policy Framework*, Commonfund Inst. 4 (Oct. 2010), http://www.commonfund.org/InvestorResources/Publications/White%20Papers/Whitepaper_Endowment%20Spending%20-%20Building%20a%20Stronger%20Policy%20Framework.pdf; *Enactment Status Map*, UPMIFA, http://uniformlaws.org/Act.aspx?title=prudent%20Management%20of%20Institutional%20Funds%20Act (last visited Apr. 3, 2011).

[197] Unif. Prudent Mgmt. of Institutional Funds Act § 4(d) cmt. (2006).

prefer to save, they may seek to bolster those savings through other channels, spending more on fundraising or even reducing financial aid."[198]

C. Infringing Institutional Autonomy

The scope of this Note does not allow for a full defense of the claim that universities have a special type of institutional autonomy with which Congress should not interfere. Nevertheless, a few preliminary considerations that help to explain this view should be mentioned as they bear on the propriety of instituting a mandatory payout rule.

The institutional autonomy argument generally takes two forms, depending on the type of payout legislation at issue. The first is a general warning against governmental infringement on universities' autonomy. Universities have historically been granted the autonomy and freedom to pursue their missions as they see fit.[199] As Justice O'Connor wrote in *Grutter v. Bollinger*,[200] the landmark case in which the Court upheld the University of Michigan Law School's admissions policy, "[w]e have long recognized that, given the important purpose of public education and the expansive freedoms of speech and thought associated with the university environment, universities occupy a special niche in our constitutional tradition."[201] Senator Lamar Alexander (R-Tenn.), a former president of the University of Tennessee[202] and a former Secretary of Education,[203] cites institutional autonomy and limited government regulation as two of the key components to the success of American higher education.[204] Applying this idea to the possibility of a mandatory distribution, Professor Dan Halperin argues that a mandatory payout would be "intrusive."[205]

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198 Weisbrod et al., *supra* note 101.

199 William A. Kaplin & Barbara A. Lee, The Law of Higher Education 627 (2006) (discussing the institutional academic freedom rights of public and private universities as recognized by the courts); *see also* Clark Kerr, *Knowledge Ethics and the New American Culture*, 26 Change 8, 15 (1994) (explaining that "[u]niversities enjoyed their autonomy historically as a result of their ethical conduct").

200 539 U.S. 306, 329 (2003).

201 *Id.* at 329. Justice O'Connor also wrote that the Court's holding "is in keeping with our tradition of giving a degree of deference to a university's academic decisions." *Id.* at 328.

202 Senator Alexander served as President at Tennessee from 1988 to 1991. *Former Presidents of the University of Tennessee*, U. of Tenn., http://president.tennessee.edu/history/index.html (last visited Feb. 13, 2011).

203 U.S. Senator Lamar Alexander, Lamar Alexander: U.S. Senator: Tenn., http://alexander.senate.gov/public/index.cfm?p=LamarAlexander (last visited Feb. 13, 2011).

204 153 Cong. Rec. S6833 (2007) (statement of Sen. Lamar Alexander).

205 Halperin, *supra* note 135, at 128. Similarly, a *USA Today* editorial argues that any mandatory payout would infringe universities' academic freedom. Editorial, *Leave Endowments Alone*, U.S.A. Today, Mar. 27, 2008, at 10A. Though "academic freedom" often denotes the notion that faculty members may pursue their teaching and research activities without fear of reprisal from their host institution or the outside world, there is also a concept of institutional academic freedom. Kaplin & Lee, *supra* note 199, at 625; Poskanzer, *supra* note 121, at 64. To what degree a payout requirement would infringe institutional "academic

A second, and more pressing, argument for autonomy emerges in response to congressional mandates that would direct funds from increased payouts specifically toward student financial aid (as opposed to other university projects).[206] Not only would this approach infringe the aforementioned principles of university independence,[207] but it could reduce strategic flexibility, as well.[208]

IV. Conclusion

Scrutiny of university endowments, and with it calls for taxation and regulation of endowments or endowment income, is poised to return now that universities are again seeing investment gains. Despite the potential appeal of a mandatory payout for endowments (given its superficial resemblance to the private foundation payout), such a "quick fix" should not be adopted for numerous reasons. First, the arguments offered by payout proponents are unpersuasive. A payout requirement will not increase affordability across the higher education sector and the reliance on the comparison to the private foundation payout is misguided. The appropriate comparison is to operating foundations, which have a far lower required payout. Second, the payout will have harmful consequences, including accelerating the academic arms race—resulting in less need-based aid being available to low- and middle-income students—and hindering colleges' ability to respond to economic fluctuations. Further, the payout will infringe university autonomy. In light of these considerations, Congress should refrain from adopting a minimum distribution requirement and allow our universities to retain the autonomy that has made them the envy of the world.

freedom" would depend at least in part on how central endowments are to the missions of universities, a question beyond the scope of this Note.

[206] *See* Hartle Remarks, *supra* note 109.

[207] *See, e.g.*, Kaplin & Lee, *supra* note 199, at 627 (explaining the constitutional claims that public and private universities can bring against government bodies "that seek to interfere with [an] institution's internal affairs").

[208] While one British report noted that American university endowments provide U.S. institutions with greater financial autonomy than British institutions, The Sutton Trust, *supra* note 184, this benefit would be largely eradicated by such legislation.