International Center for Not-for-Profit Law (ICNL)
Overview of Government-established Foundations
September 9, 2005

ICNL has prepared this memorandum at the request of the Institute for Urban Economics (IUE). This memorandum is intended to provide an introduction to the various approaches taken by states to establishing foundations. In order to provide models that will be most relevant to the Russian Federation, this memo will focus on those models adopted in states of Central and Eastern Europe. Choosing several countries which have chosen to establish state-sponsored foundations[1], ICNL will outline briefly how such foundations were established and how they are operated and managed. This memo is intended to provide an overview of this broad topic, allowing the reader to determine which models might be most useful to consider in greater detail. ICNL stands ready to provide additional information on any of the models described below, or on other issues, as needed.

Introduction

Governmentally-supported foundations may be established at all levels of government, from municipal to regional and national, international and supra-national. As such, foundations established by state entities can likewise be founded and funded in a wide variety of methods, depending upon the goals of the founding entity, as well as the legal system of the particular country or body involved. Despite the varied nature of such bodies, there are some common factors. The first, as expected, is that it is a state or government entity which acts as the founder (or, in some cases, co-founder), and this body continues to exert some level of participation or control over the donated funds (through direct management of the foundation, participation on the board of directors and/or in monitoring expenditure of state-donated funds). Secondly, although the original funding of the foundation comes directly from the government, the foundation, once established, is typically free to seek other sources of income. Beyond these basic commonalities, the procedures and forms for government-established foundations vary considerably. Hence, ICNL will seek to acquaint the reader with this topic by describing how various countries have chosen to proceed. The countries presented in this memo are: Bulgaria, Croatia, the Czech Republic and the Slovak Republic.[2]

[1] In the context of this memo, ICNL does not use the term "foundation" as a term of art. It is the most helpful term to describe the types of legal organizations described in this document. However, due to variations in terminology chosen by different countries, the models described herein may not all technically be labeled as "foundations", although they all operate, in some sense, as what ICNL would consider a foundation, i.e. a not-for-profit organization which is property-based rather than membership-based.

[2] ICNL has intentionally chosen not to discuss Hungary and the National Civil Fund Program, or other so-called "percentage philanthropy" models for government support of the non-profit sector despite potential relevance to the topic, both because "percentage philanthropy" models are a substantial topic in and of themselves, and because ICNL was not aware that stakeholders in the Russian Federation have any interest in adopting such a model. If the reader is interested in "percentage philanthropy" laws, ICNL would be happy to provide such information. In addition, a substantial amount of information on this topic may be found (in English and Hungarian) at the following website: http://www.onepercent.hu/index.html.

Bulgaria

There are multiple laws establishing government-supported foundations adopted in Bulgaria. One example of a government-established foundation in Bulgaria would be the National Culture Fund, established through the Law of Bulgaria for Protection and Development of Culture.[3] The National Culture Fund is largely operated by the Bulgarian Ministry of Culture. This Law is an example of an instance in which the Fund remains, in some sense, a government body, in that the Chairman of the management council is determined, by statute, to be the Minister of Culture. However, the law also provides that the remaining 10 "members of the management council shall be: representatives of the organizations with non profit objectives in the field of culture, creative professional organizations, culture activists, academic communities – connected with the culture, the municipalities and one representative of the Ministry of Culture and the Ministry of Finance.[4] All members of the management council are appointed by order of the Minister of Culture. The members of the Management Council are paid in accordance with an order by the Minister of Culture.

In addition, the terms of the competition for application for the resources of the Fund are determined by the Minister of Culture, although the law does require that the process be transparent and open to the public. The ultimate decision as to who shall be recipients of Fund resources must be made on a competitive basis, after holding a competition, and on the basis of the recommendations of expert commissions formed from prominent members of the relevant cultural field.

The initial resources provided to the National Culture Fund by the Law of Bulgaria for Protection and Development of Culture were not given in the form of a lump sum endowment, but rather the law allocates to the fund percentages of income collected by the government under the Law and under various other statutes. For example, the Fund receives 50% of the fines imposed for violation of copyright and related rights. In addition, the Fund receives an annual subsidy determined in the Law for the state budget of the Republic of Bulgaria, as well as having the right to receive money from grants, donations and interest from accounts of the fund.

The law does not contain provisions guarding against conflict-of-interest on the part of management of the Fund, nor does it provide for or demand a policy of recusal in the event of a vote in which a member of the management council possesses a personal or pecuniary interest in a transaction.[5] In addition, the law does not limit the distribution of resources from the Fund to non-profit organizations. Cultural organizations, nonprofit organizations and individual cultural activists may apply for Fund resources.

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[3] A similarly constituted government-supported foundation can be found in the Republic of Macedonia, where the Fund for Environment Protection and Advancement was established under the Ministry of Environment, pursuant to the Law of Macedonia for Nature and Environment Protection and Advancement. This Fund (established under articles 30 and 31 of the Law), are derived from car registration fees. The Macedonia Fund for Environment Protection and Advancement, although similar in some respects to the Bulgarian Fund, it is even less independent from its supervisory Ministry. Currently, the Fund operates essentially as a special organ within the Ministry, with close Ministry involvement in all aspects of its operation. However, the intention of the Government is that the Fund will eventually grow into a fully independent institution.

[4] *See* Chapter V., Article 26(3) of the Law of Bulgaria for Protection and Development of Culture, Prom. SG 50 1999; Amend. SG 1 2000; Corr. SG 34 2001; Amend., SG 75 2002.

[5] The absence of such provisions is not in compliance with international best practices.

Another example of a government-established foundation in Bulgaria would be the Social Investment Fund ("SIF"), established by the Bulgarian Government in 2001, which began operations in 2003.[6] This Fund is even less independent from the state, and closer aligned with its relevant Ministry (Ministry of Labor and Social Policy), than is the National Culture Fund. The Social Investment Fund is a secondary administrator of the budget credits of the Ministry of Labor and Social Policy.

As with the National Culture Fund, there was no initial large independent endowment given in the creation of the SIF. The resources of the SIF are to be drawn from state budget subsidies, state guaranteed credit arrangements as well as donations and other types of non-state support.

The board of management for the SIF consists of 12 members. An equal number of representatives should be drawn from each of: the Council of Ministers, and the representative organisations of the employers and of the workers and employees, determined by the order of Chapter Three of the Labour Code. The representatives of the Council of Ministers shall be appointed by an order of the Prime Minister.[7] According to the law establishing the SIF, the management board has "complete control" over determining the structure of the Fund, the expenditure of the resources, the determining of the annual program priorities, and many other responsibilities.

There are no specific provisions in the law enabling recovery of state resources transferred to the Fund. However, due to its close alignment with state institutions, such provisions were likely considered unnecessary. The resources allocated to the Fund would remain within reach of the government.

Although there are unfortunately no provisions preventing conflict of interest or self-dealing in the law, it does ensure some measure of transparency by requiring that the public be informed of the Fund's activities by requiring publication of the investment program of the Fund in the "central daily newspapers."[8]

Croatia

In an effort to strengthen civil society in Croatia, in October of 2003, the Croatian Parliament passed a law establishing the "National Foundation for Civil Society Development," endowing the newly established foundation with two million Kunas, derived from proceeds from the state lottery and games of chance in 2003. In addition to the initial 2 million Kuna donation, the Foundation will continue to be financed from a separate line in the state budget.[9] The Foundation is also specifically permitted to seek donations and all other lawful forms of income permitted to foundations under the Law of the Republic of Croatia on Foundations and Funds.

This Law specifies all manner of procedures affecting the Foundation, as well as stating that, with regard to issues not regulated in the Law, the Foundation will be governed by the Croatian Law on Foundations and Funds. The founder of the Foundation is the Republic of Croatia, and the Law provides that the Foundation shall acquire legal personality by being entered into the Registry of Foundations, in the same manner as a non-governmentally established foundation.

[6] *See* Law of Bulgaria on the Social Investment Fund, Prom. SG 32 2001.
[7] *See* Chapter III, Art. 10 of the Law of Bulgaria on the Social Investment Fund, Prom. SG 32 2001.
[8] *See* Chapter III, Art. 12(11) of the Law of Bulgaria on the Social Investment Fund, Prom. SG 32 2001.
[9] *See* Article 3, Paragraph 8 of the Decree of the Republic of Croatia on Criteria for Distribution and Determining Beneficiaries of a Portion of Lottery Proceeds.

The purpose of this Foundation is the "promotion and development of civil society in the Republic of Croatia."[10] The Law provides for the initial composition of the Foundation management body, the Management Board, with the manner for future nomination of Management Board members to be set forth in detail in the Foundation's statute. With regard to the initial composition of the Board, "[t]he Government of the Republic of Croatia shall appoint three members of the first Management Board from the representatives of the state administration bodies, five members from the representatives of civil society organizations and one member as a representative of local and regional self-government, following a nomination from the Government Office for Cooperation with NGOs."[11] The members of the Management Board are prohibited from receiving compensation for their services.

Consistent with international best practices, the Law contains provisions aimed at preventing the abuse of the funds allocated to the Foundation by self-interested individuals. This is accomplished through two provisions: a prohibition on self-dealing by members of the Management Board, and a provision permitting the Government of the Republic of Croatia to dismiss a member of the Management Board from office if he fails to act in compliance with the law and the general acts of the Foundation, or if he has a conflict of interest, or fails to meet any of the requirements set forth in Article 231, Paragraph 1 of the Law on Foundations and Funds. The prohibition on self-dealing provides that, "[a] member of the Management Board or some other body of the Foundation may not vote on issues in which he, his spouse, adopter or adoptee, relative by blood, either lineal or collateral, to the fourth degree, or relative by affinity to the second degree has a pecuniary interest, or on issues which concern a legal person of which he is a member, in whose management he takes part or in which he has a pecuniary interest."

While the Law specifies the basic management scheme as well as the funding sources for the Foundation, it does not provide any special provisions for recovery of state funds, nor does it provide any special limitations on the use of the transferred property. To the contrary, the Law states that "[t]he Foundation shall be liable for obligations arising from its dealings with its entire property," and "[t]he Foundation's losses shall be covered from its property."[12] Accordingly, unlike the models from Bulgaria, for example, the Government of the Republic of Croatia fully transfers ownership and responsibility for the use of the donated funds to the Foundation, without reserving any right of recovery. Consistent with this, the Law itself makes no determination as to the dispensation of the funds allocated to the Foundation in the event of dissolution, liquidation or bankruptcy, leaving this matter to be addressed in the Foundation's statutes.[13] In this sense, the Croatian regime governing its government foundation is much less rigid than that which can be seen in some other CEE countries, such as the Czech Republic or Slovakia.

As discussed earlier, the Law states that any issue not specifically regulated therein is subject to the provisions of the general Law on Foundations and Funds. Accordingly, the Foundation must comply with the Law on Foundations and Funds with regard to matters of investment practices, expenditure requirements, and even reporting requirements.[14] The Law requires the Foundation

[10] *See* Section II, Article 3 of the Law of Croatia on the "National Foundation for Civil Society Development."
[11] See Section III, Article 5(3) of the Law of Croatia on the "National Foundation for Civil Society Development."
[12] See Article 17(1) and (2) of the Law of Croatia on the "National Foundation for Civil Society Development."
[13] However, the Government retains the right to approve the Foundation's proposed statute, which must be submitted by the Manager of the Foundation (appointed by the Government).
[14] For more detailed information on legislation affecting foundations, see ICNL's Memo on Foundation Law.

to prepare only those reports required by the general Law on Foundations and Funds, although it must submit its reports to the Croatian Parliament, as well as to the state bodies required by Article 31, Paragraph 3 of the Law on Foundations and Funds.

Czech Republic

Several models of government supported foundations have been utilized in the Czech Republic. This memo will address three primary examples: (1) the Czech Foundation Investment Fund; (2) the Czech Foundation for Holocaust Victims; and (3) the Public Benefit Corporations Act.

Czech Foundation Investment Fund

In 1992, recognizing the need for stronger domestic foundations, the Czech National Council enacted an amendment to the Privatization Act awarding 1% of the returns on sale of state enterprises to a newly created fund, known as the Foundation Investment Fund ("FIF"). This entity was not established as a foundation, but rather as a joint stock company, although it was intended to operate, in principle, like a foundation.[15] At that time, the government also created the "Council on Foundations" to serve as the advisory body. The Council was intended to be the body responsible for deciding to which organizations the funds should be distributed. The system, as it was established in 1992 however, did not function, distributed no funds and soon ceased to operate at all.

One of the significant problems facing the Czech government in determining how to distribute the privatization funds dedicated to the FIF fund was the lack of an effective Law on Foundations. From 1995 to 1997, there was an ongoing debate as to whether there was a need to create a new legal entity to manage the privatization funds, referred to as the National Endowment Fund, which would operate as a new legal entity in the form of a foundation established via statute. Ultimately, this proposal was not adopted.

Instead, with the adoption of the Act of September 3, 1997 on Foundations and Endowment Funds[16], all existing foundations were compelled to reregister under the new rules, and the concept of a "registered endowment" – a portion of the total assets of the foundation which may not be sold, used as a lien, nor willfully diminished by the actions of the foundation – was created. The Czech law on foundations and endowment funds established a comprehensive scheme for regulating foundations and endowment funds.[17]

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[15] Prior to 1997, Czech foundations were largely unregulated, governed by minimal provisions in the Corporations Act and the Civil Code. According to the Czech Ministry of Economics, "the Foundation Investment Fund was intended to have the form of a portfolio investment fund with shares worth a total nominal value of 2,803 million Czech crowns transferred into it from 480 companies by October 15, 1996, in particular from companies selected for the second wave of the coupon privatization project. In the years 1995 and 1996, with regard to the rapid change of hands and, consequently, property rights to the above mentioned companies, the danger of depreciation arose for the Foundations Investment Fund portfolio shares. For that reason, in 1995, the Minister for Privatization decided to have the shares of the Foundations Investment Fund sold and the financial means thus acquired gradually deposited on a special account with the Investment and Postal Bank joint-stock company." See http://wtd.vlada.cz/scripts/detail.php?id=3952.

[16] This distinction between Foundations and Endowment Funds is that a foundation uses only the revenues from the equity and other assets to perform its activities, whereas an endowment fund uses the entirety of its property in pursuit of its goals.

[17] The Law on Foundations and Endowment Funds was amended four years later in 2002, by Act No. 210/2002 Coll.

In addition, in 1997 and 1998, the Council on Foundations was restructured, and given a new name, "The Council for Non-governmental Not-for-profit Organizations" (CNNO). This Council consists of 15 representatives from NGOs, appointed upon the recommendation of the government, and another eight members who were appointed from individual ministries of the Czech Government. The CNNO acts as a regular advisory body to the Government on the distribution of funds from the FIF, as well as on a variety of other matters affecting the Czech NGO community.[18] The CNNO is "a permanent advisory, initiation and co-ordination body of the Government of the Czech Republic (CR) in the area of non-state non-profit organisations."[19]

With the new Law on Foundations providing a framework from which to evaluate potential applicants for the funds, the newly established CNNO developed a procedure by which to determine which foundations could be eligible to receive FIF funds. The CNNO chose to limit the potential recipients of the privatization contribution to only registered foundations[20] with registered endowments.

Initially, the funds were to be distributed based on two general principles: 1) that the FIF financial contributions would be allocated only to foundations that succeed in the competitive tender, and 2) that the FIF contribution would be used for foundations' endowments and only annual revenue on such endowments would be available for distribution.

The procedure that was employed by the CNNO began with a tender for foundations interested in applying for the funds. In March 1999, the Council (divided into seven committees), evaluated the 93 applications which had been received.[21] These committees were divided by areas: health care promotion, social care promotion and humanitarian assistance, education promotion, culture promotion, environmental protection and human rights protection.

In order to qualify for the funds, applicants were required to demonstrate that they were engaged in substantial grant-giving on a nationwide basis. A seventh category was reserved for regional foundations and operating foundations (those which were not grant-giving). Ultimately, only 39 of those who applied met the formal requirements. This number was further reduced, when the Council made a formal proposal to the parliament identifying 26 foundations to receive funds. However, after extensive parliamentary debate, the Czech Parliament adopted a resolution awarding 484 million CZK to 38 foundations[22], all those which passed the test of formal requirements, and decreed that they were to be given funds in an amount proportional to the evaluation score they received during the Council's deliberative process.

In 2001, following extensive efforts by the CNNO working groups, in consultation with the Budget Committee of the Czech Parliament, the Czech Government approved Decision No. 12/2001, which set forth the new procedure by which remaining assets in the FIF were to be distributed in the second round of awards. This new procedure requires the CNNO commission to evaluate the applicants based upon criteria which reflect: (1) the ability of the foundation to

[18] The CNNO has many other duties in addition to those relating to the FIF. *See* Article 2 of the Attachment to the Governmental Resolution No. 283 of 18 March 2002. (http://wtd.vlada.cz/scripts/detail.php?id=3946).
[19] *See* Article 1 of the Attachment to the Governmental Resolution No. 283 of 18 March 2002.
[20] Registered foundations would only be those that had successfully re-registered after the passage of the 1997 Act, therefore demonstrating that they met the requirements of that Act.
[21] Foundations established by the government and those foundations financed during the previous two years from the state budget were excluded.
[22] One qualifying foundation declined to accept the funds.

raise assets (i.e. its ability to raise donor funds and to efficiently use its existing property); (2) the capacity of the foundation to serve as a financial resource to other civil organizations (such as the ratio of assets given out in grants to total income, number of grantees and so forth); and (3) its demonstrable capacity to manage its assets and property (as evaluated by the value of its endowment and the income obtained from such property). Other aspects of the evaluation include an overall assessment of the activities of the foundation, its importance to its grantees, and its general impact on Czech society.

As with the first round of grants, the Parliament, upon the recommendation of the CNNO, is entitled to make the final decision on distribution. In 2002, the Czech Parliament awarded 849 million CZK to 64 foundations.

The manner in which the grantee foundations may use FIF funds also changed between the first and second rounds of awards, due to amendments to the foundation law. In 2002, the Czech Republic adopted amendments to several laws affecting non-profit organizations, including significant amendments to the Law on Foundations and Endowment Funds. Under the 1997 law, foundations and funds were essentially limited to grant making and educational and cultural activities. Neither a foundation nor a fund were permitted to engage in any commercial activities (beyond the rental of property), except that they were entitled to buy shares in publicly traded company up to 20% of their property (excluding the endowment).[23]

In practice, these limitations proved to be too restrictive, and inhibited the ability of foundations and funds to earn sufficient income to remain sustainable and meet their statutory purposes. The 2002 amendments to the law allowed for more efficient investment of endowment assets and provided greater leniency in the use of foundation property.[24]

The FIF continues to operate and to provide funding to Czech foundations using the interest from the funds originally allocated to the Fund.

Czech Foundation for Holocaust Victims

As with the Bulgarian examples, the Czech government has also chosen to establish issue-specific state-endowed foundations, although these foundations are structured quite differently. One example is the Czech Foundation for Holocaust Victims, which was established using funds from the FIF to create an independent government-established foundation. In 2000, based on Resolution No. 1002/1999 of the Chamber of Deputies of the Parliament of the Czech Republic, 300 million CZK were transferred from the FIF to the Foundation for Holocaust Victims. The statutes of this foundation[25] provide an example of how a state may choose to establish a foundation which is less governmentally-aligned than the Bulgarian examples. The statutes of the Foundation for Holocaust Victims provide for continued government involvement in the management of the foundation through its power to nominate members to the Board of Directors, but the state representatives do not form a majority. In this particular case, the Board of Directors

[23] For greater detail on the specific details of regulation of endowments and other general issues relating to regulation of foundations, please see ICNL's Memo on Foundation Law.

[24] Some notable changes include: (1) the ability to change the composition of the endowment, unless explicitly prohibited by the founder or donor; (2) the possibility to invest in foreign banks, as long as they have a branch in the Czech Republic; (3) investment assets may be issued or registered in any country, provided that the country is a member of the Organization for Economic Cooperation and Development; and (4) exempting the profit made from selling securities placed in the endowment of a foundation exempt from special income tax.

[25] The Statutes are available in Czech and English at http://www.fondholocaust.cz.

consists of nine members, of which 4 will be continually appointed by members of the Czech government, one by the Vice-Premier of the government of the CR, one upon recommendation of the Minister of Foreign Affairs, one upon a recommendation of the Minister of Culture, and one from the Minister of Finances. The remaining 5 directors are nominated by the Federation of Jewish Communities in the Czech Republic. Endowment benefits are granted by a decision of the Board of Directors. In addition, the statutes provide for a Supervisory Board of 3 persons, of which one member shall be appointed based upon a recommendation made by the National Property Fund of the Czech Republic (the source of FIF funds).

Public Benefit Corporations

In addition to the other models discussed above, the Czech Republic chose to include the state as an entity capable of establishing a Public Benefit Corporation ("PBC").[26] In fact, some commentators suggest that, "this new legal form was originally conceived as a tool of privatization of the state-subsidised quasi-NGOs surviving from the previous regime."[27] Under this law, the state acts as any other founder would, and is subject to the same reporting and governance requirements as non-state organizations established under the Law, except that there are certain provisions in the law which appear to apply particularly to PBCs established by the state.

In practice, PBCs are the type of legal entity which a state could use to delegate the performance of certain social, educational and health services, without providing for a large endowment up-front.[28] In addition, because the Law on Foundations and Funds precluded operating foundations (those which do not give grants but rather implement public and social services) from registration (due to the fact that foundations and funds are prohibited from engaging in commercial activities), many operating foundations chose to re-register as PBCs after the new law on foundations was adopted.

In order to provide for the protection of government funds allocated to a PBC, Article 4 of the Law on Public Benefit Corporations provides that "the Deed of Establishment may determine that a specific number of members of the Board of Directors or the Supervisory Board shall be elected or appointed upon the motion of a specific circle of citizens or a specific legal entity, local self-government body or a body of the national government. Optionally, the Deed of Establishment may specify that specific property endowed upon establishment may not be alienated or mortgaged or that a specific type of the publicly beneficial services rendered may be modified under specific terms and conditions."

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[26] Act No. 248/1995 Coll. of 28th September 1995 on "Public Benefit Corporations and on the change and amendment of some laws." In practice, a Public Benefit Corporation is similar to a concept known as an "operating foundation", and may be understood as a foundation without endowment or be compared to nonprofit corporations (without membership). Essentially, PBCs are "private entities established to provide publicly beneficial services, such as education and health care, that represent their source of income. [SIC] To finance their activities, PBOs use deposits of founders, presents and bequests, funds of the PBO, and they can also ask for subsidies from the state and municipalities' budget." *See* "The Nonprofit Sector in the Czech Republic," Petra Brhlikova, Discussion Paper No. 2004-128, May 2004.

[27] *See* "Amendments to Legislation Affecting NGOs in the Czech Republic," Petr Pajas, Volume 4, Issue 4, *International Journal of Not-for-Profit Law*, July 2002.

[28] Unlike foundations, which have a minimum endowment requirement of 500,000 CZK, PBCs are not subject to this strict requirement.

Slovak Republic

In 2002, the Parliament of the Slovak Republic adopted a set of amendments affecting the regulation and funding of non-profit organizations. Relevant to this discussion is the Act No. 13/2002 on Conditions of Transformation of Certain Budgetary Organizations and Subsidiary Organizations into Non-Profit Organizations providing Generally Beneficial Services ("PBCs")[29] ("Transformation Law") and on Amendment and Change of Act No. 92/1991 on Conditions of Transfer of State Property on Third Persons. This Transformation Law made it possible to transform existing governmental bodies into PBCs. PBCs typically operate in the areas of health care, social services, education, or cultural or sports activities.

Interestingly, PBCs are the only legal form of non-profit organization in the Slovak Republic that is permitted to deliver health care services.[30] The reason for this is likely because the Transformation Act itself was "motivated by the state's intention to decrease its ownership in health and social care provision."[31]

The Transformation Law sets forth a procedure by which members of the government can nominate a particular government body or entity to be transformed into a PBC. According to the Transformation Law, for example, the Ministry of Health Care can select certain facilities under its auspices, and transform them into a non-profit form. The procedure by which this occurs is that the Ministry first buys all of the debts of the institution, and then co-founds a PBC, often in cooperation with the relevant municipality and, in some cases, the institution's employees. The Ministry then transfers the property of the state facility to the newly established not-for-profit organization.

The 2002 amendments to the Law of the Slovak Republic on Non-profit Organizations Providing Generally Beneficial Services ("PBC Law") established the concept of so-called "Priority Property", i.e. that property that derives from the state via the Transformation Law. These amendments to the PBC Law, adopted in conjunction with the Transformation Law, place strict requirements as to the treatment of so-called Priority Property. These provisions serve to guarantee that such property will not be alienated, that it will remain with the PBC and be spent for publicly beneficial purposes.

The PBC Law generally details the structure and function that these former government entities must adopt. Government-established PBCs take the same form as non-governmentally established organizations. However, as mentioned above, there are special provisions in the PBC Law which impose special treatment on assets of a PBC that have been endowed by the Government pursuant to the Transformation Law, i.e. Priority Property. According to Section 31a(1) of the PBC Law, "the priority property is such a part of the state property, which the state as a founder or co-founder endows to the non-profit organization according to the special law [Transformation Law] and which is to be used exclusively for securing public benefit services."

Priority Property cannot be used as a security or to secure obligations of the non-profit organizations or a third person. In addition, it cannot be sold, donated, rented or lent, is not

[29] This legal entity is much like the legal form - Public Benefit Corporations - adopted in the Czech Republic. They are, at essence, operating foundations – i.e., non-membership organizations which provide services of public benefit.

[30] *See* "The Evolution of the Third Sector in Slovakia," Katarina Svitkova, January 16, 2004, Section 4.4, P. 24.

[31] *Id*., p. 25.

subject to liquidation, and any real estate that is part of the Priority Property must be entered into the Register of Real Estates. This provision is intended to prevent the Government property from being squandered or misappropriated. However, the law does not provide for the funds to be forfeited to the state in the event of cessation or liquidation. As with non-governmentally established organizations, such funds should be transferred to another non-profit organization or foundation.

In order to ensure the government's ability to continue to exert some control over the transformed entity, the PBC Law explicitly provides that the "Founder's Deed" may specify that a certain number of members of the Board of Directors and/or the Supervisory Board may be elected based on nomination by a specified physical person, on the proposal of a specific legal person, or of a body of the territorial self-government or the state administrative body.[32]

The PBC Law also contains detailed requirements pertaining to the management and supervisory structure of a PBC. All PBCs must have a Board of Directors and an Executive Manager, and those with resources over 5,000,000 SKK or those which possess Priority Property must also have a Supervisory Board. The minimum number of members of the Board of Directors is three. The Executive Manager is entitled to participate in Board of Directors' meetings but is limited to an advisory vote. The Supervisory Board acts as a supervisory body of the PBC, and is also required to have at least three members (who may not also be the Executive Director or a member of the Board of Directors). Membership on both the Board of Directors and the Supervisory Board must be voluntary and unpaid, although members of either Board are eligible for reimbursement of certain direct expenses associated with their service.

The PBC Law also contains several provisions designed to limit potential abuses of property, including a requirement that both members the Boards and the Executive Director be persons of "irreproachable character"[33], as well as a provision designed to prohibit conflict of interests. However, the conflict of interest provision present in the PBC Law is simply not sufficiently detailed to be a genuine obstacle to abuse. In addition, there is no provision on recusal in the event that a Board member or the Executive Director has a personal interest in the relevant transaction being voted upon.

Conclusion

ICNL would be pleased to provide additional information on any of the models described herein, as well as to answer questions regarding countries not addressed in this memo. As the reader should be able to ascertain, there are many models available for government establishment of foundations. ICNL does not recommend any particular model over another. However, it would caution that, although government-established foundations are quite common and acceptable, they are peculiarly subject to actual and perceived favoritism on the part of the government. Such organizations are frequently (both fairly and unfairly) vulnerable to public criticism that such entities are more likely to "receive an unfair competitive advantage or be used inappropriately to benefit state officials, directly or indirectly, either politically or monetarily."[34] The solution to this potential problem is simply to provide that any law or regulation establishing such an

[32] *See* Section 7(a) of the Law of the Slovak Republic on Non-profit Organizations Providing Generally Beneficial Services, No. 213/1997 Coll., Amend. No. 35/2002, adopted July 2, 1997.
[33] According to the Law, this means a person who has not been convicted of purposefully committing a crime.
[34] *See* "Guidelines on Laws Affecting Civil Society Organizations," 2d edition, Open Society Institute, 2004, p. 93.

organization contain provisions which will ensure sufficient transparency and oversight to minimize the potential for such abuses to occur.