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GENERAL

A Different Kind of Donor-Advised Fund Story

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The proliferation of the donor-advised fund (DAF) model of charitable donation has been one of the biggest recent trends in philanthropy. In both news and commentary articles, experts have weighed in on the pros and cons of DAFs including the possible **need for more regulation** and oversight.

In late November 2018, a U.S. Magistrate Judge from the Northern District of California issued a ruling that **Fidelity Charitable,** now the biggest donor-advised fund in the nation, surely did not welcome. It is being **sued by a couple who donated** some $100 million in stock. They allege that, contrary to representations and assurances by Fidelity agents, the DAF liquidated the stock holdings almost immediately. This sale caused the share values to crash and damaged the couple's claim to a hefty charitable deduction.

Fidelity filed a Motion to Dismiss the lawsuit but Judge Jacqueline Scott Corle sided with the plaintiffs in this early and critical stage of the litigation. She ruled that the claim has legal merit and that these donors have standing to sue on this matter.

Fidelity Charitable, which opened its doors in 1991 as a 501(c)(3) public charity, has an "independent board of trustees" comprising "dedicated professionals from across the nation who lend their deep expertise to" Fidelity's "mission of growing philanthropy." Notwithstanding this early setback, Fidelity vows to vigorously oppose the lawsuit going forward.

Alleged Wrongdoing

The plaintiffs in *Fairbairn v. Fidelity Investments Charitable Gift Fund* (N.D. CA, No. 18-cv-04881, 11/28/18) are Emily and Malcolm Fairbairn of San Francisco. They operate Ascend Capital, an investment group that "manages billions of dollars" for clients. According to court pleadings and the ruling on this motion, they faced a "substantial" tax liability for 2017. So the couple researched firms sponsoring donor-advised funds to determine their best course of action for making a hefty charitable gift with a corresponding tax deduction.

Specifically, the Fairbairns wanted to **donate 1.9 million shares** of a company called Energous. That stock had just leaped 39% after the FCC had approved its key technology. If the Fairburns sold the stock directly, the couple would face a large capital gains tax liability. If they donated it to a DAF, then the couple would have "**more money for a fund** to fight Lyme disease," a cause of great importance to them.

Based on the representations and assurances of Fidelity agents, Mr. and Mrs. Fairbairn deposited 700,000 shares with Fidelity on December 28, 2017, and 1.2 million more the next day, which was the last trading day of the year. To the dismay of these donors, Fidelity liquidated all 1.9 million of the donated stock in a three-hour window on December 29th. According to the lawsuit allegations, this caused a loss of "tens of millions of dollars" of overall value and **wreaked havoc on the Fairbairns' proposed claim** for a charitable deduction.

They allege that, on December 27, 2017, they "spoke with a representative of Fidelity, who **'aggressively pitched' them** on why Fidelity would be a better vehicle than JP Morgan or Vanguard." The agent "repeatedly boasted of Fidelity's sophistication and 'superior ability to handle complex assets.'"

They had expressed particular concerns about what they characterize as Fidelity's policy and practice of dumping stock "at the earliest possible date." The Fairbairns allege they were reassured when Fidelity Charitable, through its agents, "had given them **four promises to convince them to donate** their Energous shares: It would use sophisticated, state-of-the-art tactics to liquidate large blocks of stock; it wouldn't trade more than 10 percent of the daily volume; it would let the Fairburns oversee the price limit; and it wouldn't liquidate shares until the beginning of 2018."

The Litigation Issues

The Fairbairns filed a lawsuit in August 2018, claiming misrepresentation, breach of contract, negligence, and violation of the California Unfair Competition Law. Defendant Fidelity Charitable then filed the motion to dismiss which was the subject of the recent court ruling.

Fidelity made several key arguments in opposition to the litigation. First, Fidelity asserted that these plaintiffs' Complaint was not argued with the specificity required for fraud/misrepresentation complaints under the Federal Rules of Civil Procedure. The **Court disagreed**, ruling that the Complaint had sufficiently detailed allegations "to put Fidelity on notice of the particular misconduct charged." The Court ruled also that the agents' promises to use "state-of-the-art methods" for liquidating stock were not mere (nonactionable) "puffery."

Fidelity also defended the lawsuit on grounds that the plaintiffs "**lack standing to sue** because the Attorney General had exclusive authority to bring such cases." The court reviewed both California and Massachusetts law, ruling that, while both of these states generally grant the attorney general primary authority, both also have exceptions when someone "has a particularized interest beyond that of the general public."

In this case, the court found, **plaintiffs have such a "particularized interest"** for several reasons. First, Fidelity holds the donated funds in a "dedicated account" and makes eventual donations "in the donors' name." Second, Fidelity gives donors "exclusive advisory rights" over the fund. Third, the firm states it will not take money out of the account "without action by the donors." Fourth, while Fidelity retains veto power over the donors' decisions, it exercises that power only when the donor attempts to "use the money for an improper or non-charitable purpose."

Conclusion

This ruling on Fidelity's Motion to Dismiss is just the first one in what may well turn out to be protracted litigation that should be of interest to the nation's donor-advised funds as well as to their present and prospective donor-clients.

In particular, the "standing to sue" element is critical; the court ruled that the donors have a "special relationship" to the fund administering their DAF accounts and "to the gifts bearing" their names. – giving them **"standing along with the Attorney General** to enforce their expectations for the Fund, especially when the DAF sponsor gives them additional rights."