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From: Steve Leimberg's Charitable Planning Newsletter

Subject: Richard L. Fox: Fidelity Investments Charitable Gift Fund Prevails in High Profile Lawsuit Brought by Donors to Donor Advised Fund Alleging Broken Promises and Negligent Trading Relating to Liquidation of Donated Stock

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"Fairbairn v. Fidelity Charitable raises important issues as to the effect of promises made by a sponsoring organization of a DAF and is a cautionary tale to sponsors of DAFs and donors alike. Both sponsoring organizations and donors alike should carefully consider the tax consequences of any agreement purportedly providing donors with legally enforceable rights, and sponsoring organizations should be prepared to abide by any rights provided to donors. Donors should also consider the effect of not retaining legally enforceable rights, given that the sponsoring organization would have ultimate control over contributed assets with the power, among other things, to liquidate donated securities in its sole and absolute discretion, subject only to the donors retaining non-binding advisory privileges."

Richard L. Fox provides members with timely and important commentary on *Fairbairn v. Fidelity Investments Charitable Gift Fund*.

Richard L. Fox is an attorney and shareholder at **Buchanan Ingersoll & Rooney** (www.bipc.com). Richard is the author of the treatise, Charitable Giving: Taxation, Planning and Strategies, a Thomson Reuters/Warren, Gorham and Lamont publication, writes a national bulletin on charitable giving, and writes and speaks frequently on issues pertaining to nonprofit organizations, estate planning and philanthropy. Richard is also a Fellow of the American College of Trust and Estate Counsel (ACTEC).

Here is his commentary:

EXECUTIVE SUMMARY:

In the highly publicized case of *Fairbairn v. Fidelity Investments Charitable Gift Fund*, as initially discussed in Charitable Newsletter #300 by Richard L. Fox (August 31, 2020), the donors, Emily and Malcolm Fairbairn, made a charitable contribution of 1.93 million shares prior to the end of 2017 of a small public company, known as Energous, to establish a donor advised fund ("DAF") at Fidelity Investments Charitable Gift Fund ("Fidelity Charitable").

In light of their concerns about the liquidation process of such a large block of contributed shares, the Fairbairns claimed that in order to induce them to make the contribution to a Fidelity Charitable DAF, Fidelity Charitable made the following legally enforceable promises, albeit not memorialized in writing or any contemporaneous record, as to how it would handle the liquidation of the 1.93 million shares of Energous stock: (1) it would employ sophisticated, state-of-the-art methods for liquidating large blocks of stock; (2) it would not trade more than 10% of the daily trading volume of Energous shares; (3) it would not liquidate any shares until the beginning of 2018; and (4) it would allow the Fairbairns to advise on a price limit.

The Fairbairns asserted that in reliance of these promises, they made their donation of the 1.93 million shares of Energous to Fidelity Charitable at the end of 2017, including 1.2 million shares on December 29, 2017. However, rather than adhering to its alleged promises regarding the liquidation process it would utilize, Fidelity Charitable liquidated the entire block of donated shares over a two and a half hour trading window on December 29, 2017, the last business day of the year, causing a more than 30% run-down of the stock value.

The Fairbairns subsequently brought suit against Fidelity Charitable on August 10, 2018 based upon its failure to adhere to the promises it had made in connection with their planned liquidation of the donated Energous shares, leaving the Fairbairns with tens of millions of dollars less in their Fidelity Charitable DAF and causing a significant reduction in the amount of the charitable income tax deduction claimed on their 2017 income tax return. The Fairbairns also contended that apart from its alleged promises, Fidelity Charitable's liquidation of the donated Energous shares violated the duty of care Fidelity Charitable owed to them by its negligent handling of the liquidation of the donated shares. They asserted that a reasonably prudent investor in Fidelity Charitable's position would not have sold all

1.93 million donated Energous shares in the last two and a half hours of the last trading day of 2017.

In an earlier motion for summary judgement filed on February 19, 2020, Fidelity Charitable asserted that as a result of the Fairbairns claiming a charitable income tax on the basis of the federal tax requirement that a sponsoring organization of a DAF have exclusive legal control over the assets contributed to a DAF, the Fairbairns were estopped from asserting that they were induced to donate their shares through legally enforceable promises as to the disposition of their contributed shares. In a decision dated March 2, 2020 following an oral argument on February 20, 2020, the court denied Fidelity Charitable's motion for summary judgement, finding that "Fidelity Charitable has not proved that the Fairbairns' representation on their 2017 federal tax return that their donation of Energous stock to Fidelity Charitable is tax deductible clearly contradicts their contention that Fidelity Charitable made the asserted legally-enforceable promises."

In denying Fidelity Charitable's motion for summary judgement, the court paved the way for the case to go to trial, leaving Fidelity Charitable having to assert the unenforceability of its alleged promises on grounds other than on the basis of the tax law requirement of a sponsoring organization's exclusive control over assets contributed to a DAF.

A bench trial took place before a federal magistrate judge over seven days between October 19 and October 28, 2020, after which the parties filed briefs and closing arguments were held on December 4, 2020.

In a decision dated February 26, 2021, the court rejected the arguments of the Fairbairns and therefore held in favor of Fidelity Charitable. As to the asserted breach of promises by the Fidelity Charitable, the court found that the Fairbairns did not prove by a preponderance of the evidence that Fidelity Charity had actually made the promises alleged it had made by the Fairbairns. The court further held that even if the promises had in fact been made by Fidelity Charity, under the facts and circumstances of the case, the Fairbairns "could not have reasonably relied on those promises in deciding to donate the Energous stock to their Fidelity Charitable DAF."

In addressing the negligence issue, the court stated a recovery under the negligence claim could only succeed if Fidelity Charitable and the Fairbairns has a "special relationship." Although the court stated that there were certain factors indicating that such a relationship existed, the court did not opine on whether a special relationship existed because the Fairbairns did not persuade the court that even if a duty was owed, that it was breached. Therefore, because the court found that Fidelity Charitable did not breach a duty of care in liquidating the Energous shares, the court declined to decide whether Fidelity Charitable even owned a duty of care to the Fairbairns in the first instance on the basis of the existence of a special relationship between Fidelity Charitable and the Fairbairns.

Fairbairn v. Fidelity Charitable raises important issues as to the effect of promises made by a sponsoring organization of a DAF and is a cautionary tale to sponsors of DAFs and donors alike. Both sponsoring organizations and donors alike should carefully consider the tax consequences of any agreement purportedly providing donors with legally enforceable rights, and sponsoring organizations should be prepared to abide by any rights provided to donors. Donors should also consider the effect of not retaining legally enforceable rights, given that the sponsoring organization would have ultimate control over contributed assets with the power, among other things, to liquidate donated securities in its sole and absolute discretion, subject only to the donors retaining non-binding advisory privileges.

FACTS:

Background

In Fairbairn v. Fidelity Investments Charitable Gift Fund[i] ("Fidelity Charitable"), the donors, Emily and Malcolm Fairbairn, decided to make a charitable contribution of publicly traded stock prior to the end of 2017 in order to offset substantial income – approximately $250 million - they had realized during the year.[ii] At that same time, they desired to create a philanthropic vehicle to hold the sale proceeds to facilitate their long-term charitable giving objectives.

The Fairbairns held a large stock position in a small public company known as Energous. On December 20, 2017, the FCC approved certain Energous technology and, after the FCC approval became public on December 27, 2017, the share price of Energous stock rose dramatically. The Fairbairns then proposed to contribute 1.93 million shares of Energous stock, valued at approximately $100 million, prior to the end of 2017.

Having previously run a San Francisco-based registered investment advisory firm and being successful former hedge fund managers, the Fairbairns were keenly aware that liquidating such a large block of stock can be a delicate process and if not executed properly can cause a stock's value to crash, thereby substantially reducing the amount of funds available to further their philanthropic objectives.

Rather than contribute the shares to a private foundation that would have offered them ultimate control over the liquidation process, the Fairbairns decided to contribute the shares to Fidelity Charitable, an IRC § 501(c)(3) public charity,[iii] to fund a donor advised fund ("DAF").[iv] Using a DAF instead of a private foundation offered the Fairbairns more favorable income tax treatment with respect to the available charitable income tax deduction because a DAF is treated as a component part of a public charity and, therefore, a contribution to a DAF is considered to be made to a public charity.[v] A DAF also avoids the restrictive and complex excise tax regime under Chapter 42 of the Internal Revenue Code applicable to private foundations, including the requirement of an annual payout of 5% of the fair market value of the foundation's assets and the imposition of a special net investment excise tax of 1.39%.[vi] Like a private foundation, however, a DAF can have a name identified by reference to its donor and make distributions to further a donor's charitable giving objectives.

A DAF, unlike a private foundation, does not offer control to a donor, a key distinction between a DAF and a private foundation. Indeed, the very premise of the tax advantages of a DAF over a private foundation is the complete lack of donor control.[vii] Under IRC § 4966(d)(2)(A)(ii), a DAF must be "owned and controlled" by the sponsoring organization - in this case, Fidelity Charitable, and under IRC § 170(f)(18), a donor to a DAF may not claim a charitable income tax deduction unless the donor obtains a contemporaneous written acknowledgment from the sponsoring organization "that such organization has exclusive control over the assets contributed." Although the sponsoring organization must have ownership and exclusive control over a DAF, the donor "has, or reasonably expects to have, advisory privileges with respect to the distribution or investment of amounts held in such fund or account by reason of the donor's status as a donor."[viii]

Prior to their contribution of the Energous stock, the Fairbairns grew concerned when they learned that the guidelines of Fidelity Charitable simply stated that it liquidates donated stock “at the earliest possible date,” an approach that gave the Fairbairns pause and caused then to reconsider making their contribution using a Fidelity Charitable DAF. According to the Fairbairns, in order to convince them to use a Fidelity Charity DAF, Fidelity Charitable made personalized promises to the Fairbairns regarding the manner in which their donated stock would be liquidated, which included not trading more than 10% of the daily volume of the Energous stock and not making any sales of the stock until 2018.

Specifically, the Fairbairns alleged that Fidelity Charitable representative Justin Kunz made four separate promises December 27 or December 28, 2017 to entice them to donate 1.93 million-WATT shares to their Fidelity Charitable DAF:

- Fidelity Charitable would not trade more than 10% of the daily trading volume of Energous shares;

- Fidelity Charitable would employ sophisticated, state-of-the art methods for liquidating large blocks of stock;

- Fidelity Charitable would allow the Fairbairns to advise on a price limit (i.e., a point below which Fidelity would not sell shares without first consulting the Fairbairns), and

- Fidelity would not liquidate any of the donated Energous shares until 2018, the new year.

The Fairbairns asserted that in reliance of these promises, they made their donation of the 1.93 million shares of Energous to Fidelity Charitable at the end of 2017, including 1.2 million shares on December 29, 2017. However, rather than adhering to its alleged promises regarding the liquidation process it would utilize, Fidelity Charitable liquidated the entire block of donated shares over a two and a half hour trading window on December 29, 2017, the last business day of the year, causing a more than 30% run-down of the stock value.

The Fairbairns also contended that apart from its alleged promises, Fidelity Charitable's liquidation of the donated Energous shares violated the duty of care Fidelity Charitable owed to them. They asserted that a reasonably prudent investor in Fidelity Charitable's position would not have sold all

1.93 million donated Energous shares in the last two and a half hours of the last trading day of 2017.

The Fairbairns subsequently brought suit against Fidelity Charitable based upon its failure to adhere to the promises it had made and its violation of the duty of care owed to them in connection with the liquidation of the Energous shares, leaving the Fairbairns with tens of millions of dollars less in their Fidelity Charitable DAF and causing a significant reduction in the amount of the charitable income tax deduction claimed on their 2017 income tax return. In their complaint filed on August 10, 2018 in the U.S. District Court in the Northern District of California against Fidelity Charitable, the Fairbairns accused Fidelity Charitable of "making false promises to secure a $100 million donation … and then outrageously mishandling the donation, costing the Fairbairns millions of dollars and severely impairing their ability to support important charitable causes."

In a motion for summary judgement filed on February 19, 2020, Fidelity Charitable asserted that as a result of the Fairbairns claiming a charitable income tax on the basis of the federal tax requirement that a sponsoring organization of a DAF have exclusive legal control over the assets contributed to a DAF, the Fairbairns were estopped from asserting that they were induced to donate their shares through legally enforceable promises as to the disposition of their contributed shares. In a decision dated March 2, 2020 following an oral argument on February 20, 2020, the court denied Fidelity Charitable's motion for summary judgement, finding that "Fidelity Charitable has not proved that the Fairbairns' representation on their 2017 federal tax return that their donation of Energous stock to Fidelity Charitable is tax deductible clearly contradicts their contention that Fidelity Charitable made the asserted legally-enforceable promises."

Interestingly, the court noted that the statute of limitations on the Fairbairns' 2017 has not yet run and, in this regard, stated that "if the Fairbairns prove that Fidelity Charitable made the legally enforceable promises, and Fidelity Charitable is correct that such legally enforceable promises disqualify the donation from a charitable tax deduction, the IRS may take action against the Fairbairns to recover any improper deduction. No 'taxpayer estoppel' is needed to prevent any unfairness: Fidelity would be held to its promises, and the Fairbairns would suffer the consequences, if any, of enforcing those promises."

In denying Fidelity Charitable's motion for summary judgement, the court paved the way for the case to go to trial, leaving Fidelity Charitable having to assert the unenforceability of its alleged promises on grounds other than on the basis of the tax law requirement of a sponsoring organization's exclusive control over assets contributed to a DAF.

A bench trial took place before a federal magistrate judge over seven days between October 19 and October 28, 2020, after which the parties filed briefs and closing arguments were held on December 4, 2020.

Analysis of Decision by the Court

The court first addressed the four separate "promise claims" the Fairbairns asserted by Fidelity Charitable in order to induce them to donate the 1.93 million shares of Energous stock. To succeed, the court stated that each of these claims requires the Fairbairns to prove by a preponderance of the evidence that Justin Kunz, the Fidelity Charitable representative, "made at least one of the alleged promises. If the promise was made, the Fairbairns must also prove that Fidelity Charitable did not do as promised, and finally that the Fairbairns relied on and were harmed by the untrue/broken promise."[ix]

The 10% Daily Trading Volume Promise

On the alleged promise that Fidelity Charitable would not trade more than 10% of the daily trading volume of Energous shares, the court found that Fidelity Charitable had actually adhered to that standard. Indeed, the court noted that the trades made by Fidelity Charitable represented only 6.7% of the shares trade during the day – "well below the promised 10%." At the trial, apparently after recognizing that Fidelity Charitable had actually complied with the 10% of daily trading volume restriction, the Fairbairns attempted to characterize the 10% of daily trading volume representation as a promise to trade 10% of the volume trading during the period that Fidelity Charitable "was actively trading the Fairbairns' donated Energous shares "as opposed to the volume of the entire trading day." The court rejected this argument as "unpersuasive," as the evidence presented to the court clearly indicated that the 10% related to the "daily trading volume."

The Sophisticated Means Promise

On their alleged “sophisticated means promise” made by Fidelity Charitable, the court found that the Fairbairns did not prove this allegation by a preponderance of the evidence. While the complaint filed by the Fairbairns alleged that Fidelity Charitable promised to use sophisticated means and "state of the art" methods for liquidating large blocks of stock, the court noted that Mr. Fairbairn testified that Mr. Kunz “never used those words” and Mrs. Fairbairn “did not recall Kunz using those words.” And, the court stated, there was nothing in the documentary evidence that supported that promise having been made.

The court did acknowledge that the record did support a finding that Mr. Kunz told the Fairbairns that Fidelity Charitable would be "gentle" with their donation, but that such statement did not support a finding that he promised them Fidelity Charitable would use "state of the art" or sophisticated means and that, based upon his January 16, 2018 email, Mr. Fairbairn had stated that “being gentle meant trading less than 10% of trading volume.” While Kunz certainly touted Fidelity's trading experience and processes to encourage the Fairbairns to donate to Fidelity Charitable, the court found that “he did not make the specific promise the Fairbairns alleged in the complaint.”

In any event, the court stated that the Fairbairns did not prove that Fidelity Charitable did not use sophisticated and "state-of-the art" trading methods in its liquidation of the 1.93 million shares of Energous stock. Mrs. Fairbairn testified, and the documentary record confirms, that she wanted Capital Markets Group to liquidate the donated shares and a trader from Capital Markets Group did so. Further, the trader used time-weighted average price (TWAP) and volume-weighted average price (VWAP) algorithms to sell the shares, and the algorithms divided the parent orders into smaller child orders and took other steps to hide the trades from the market. These steps, according to the court, were consistent with Mrs. Fairbairn’s testimony that sophisticated trading would involve hiding the trades. Further, the Fairbairns' expert, Dr. Lawrence Harris, a University of Southern California finance professor, testified that the algorithms Fidelity Charitable utilized "are a typical tool used by traders to sell large blocks of stock."

The Advising on Price/Not Selling Until 2018 Promises

On the allegation that Fidelity Charitable promised to allow the Fairbairns to advise on the selling price of the donated shares and that it would not sell the donated shares until 2018, the court held that the Fairbairns did not prove by a preponderance of the evidence that Mr. Kunz of Fidelity Charitable told the Fairbairns that they could advise on the price at which Fidelity Charitable would sell the donated WATT shares or that Fidelity Charitable would not sell a single share of WATT until January 2018.

The court noted that there was no contemporaneous written record to support that Mr. Kunz of Fidelity Charitable made such promise, pointed to the facts that there were no emails by Mr. Kunz in which he implies that he understood no trading would occur until 2018 or that the Fairbairns would have the opportunity to advise on the sell price. The court emphasized that this omission was “especially damaging to the Fairbairns' contention that they were specifically promised that no [Energous] shares would be sold until 2018 given that in February 2017 Emily was told that the shares would be liquidated automatically upon donation.”

Indeed, the court note that in response to an inquiry from Mrs. Fairbairn about the sale of the donated shares, a member of the Fidelity Charitable Family Office email Mrs. Fairbairn on February 14, 2017, stating as follows:

> After reviewing with our Private Donor Group, they were able to confirm that shares are automatically sold once they arrive in the DAF. For thinly traded shares it may take longer to liquidate all shares if it is a large amount, but once shares are sold the proceeds settle into the investment pools in the DAF.

Having been expressly told that Fidelity Charitable' s policy is to sell automatically upon donation, the court stated that it would have been unreasonable for Mrs. Fairbairn to later rely on an oral promise that no shares would be sold until 2018 rather than automatically as is the policy. And, as the court noted, “that policy was also in the written materials Fidelity Charitable provided to the Fairbairns.” The court further noted that in none of the various emails that Mrs. Fairbairn sent to Fidelity Charitable did she ask for control over the timing of the donation's liquidation or suggest that such control had already been promised to her. Nor did she ask for the opportunity to advise on a price limit for the liquidation.

The court also indicated that Mr. Fairbairn also failed to make any contemporaneous record of the alleged promises and that Mr. Fairbairn never made any communication to Fidelity Charitable indicating their promise that no shares would be sold until 2018 and the that donors had the right to advise on the liquidation price.

The Fairbairns' conduct after they learned that the shares had all been sold on December 29, 2017 also was determined to weigh against them in finding that such promises had been made. When Mr. Fairbairn learned on January 5, 2018 about the December 29, 2017 sale of the Energous shares, he did not confront Mr. Kunz by email or telephone about the alleged broken promises. Indeed, the court noted that it was not until January 15, 2018 that the Fairbairns even mentioned to Fidelity Charitable that the liquidation had violated promises made to them. Mr. Fairbairn testified that he was too angry and needed to cool off would make sense for a few hours, or maybe a few days, but the court found that “10 days of silence is hard to understand.”

Reliance/Harm

The court then turned to the issue of whether even if Fidelity had made the promises alleged by the Fairbairns, whether Fairbairns could have reasonably relied on those promises in deciding whether to donate the Energous stock to their Fidelity Charitable. The court found that even if the promises had been made by Fidelity Charity on December 27 or December 28, the Fairbairns “could not have reasonably relied on those promises in deciding to donate the Energous stock to their Fidelity Charitable DAF.”

Mr. Fairbairn learned of the FCC approval on December 20 and two days later she made a note to herself to transfer the Energous shares from the Fairbairns' JP Morgan account to Fidelity Charitable, which was well before the promises by Fidelity Charitable were allegedly made. Further, neither Mr. nor Mrs. Fairbairn communicated with JP Morgan in December 2017, even when JP Morgan emailed them on December 13, 2017 to solicit a transfer of shares to their JP Morgan DAF.

December 27 or 28, 2017, the dates when the promises were allegedly made, was too late to facilitate the donation of the shares to JP Morgan, especially since the only evidence as to JP Morgan in the record is that it recommended that the transfer of shares be initiated by December 22, 2017 to ensure that the shares were donated by December 29, 2017. And as the Fairbairns had to make the donation because of their looming tax bill in light of the repatriation of their off-shore income, the court opined that "not making any donation of the Energous shares was not an option," thereby evidencing that the Fairbairns' contribution was not made on the basis of their relying on any promises made by Fidelity Charitable but, instead, on the absolute need to generate a charitable income tax deduction before the year of 2017 to save them millions of dollars in federal income tax.

In the end, the court held that the Fairbairns had failed to prove that Fidelity Charitable made the alleged promises and, even if it did, the Fairbairns could not have reasonably relied on those promises in deciding to donate the Energous stock to their Fidelity Charitable DAF. Therefore, the court entered judgement in favor of Fidelity Charity and against the Fairbairns on their claims for broken promises made by Fidelity Charitable.

In connection with this holding, the court cautioned that it did not find that either Fairbairn did not tell what they believed to be the truth about the alleged promises. Instead, the court stated that it need only decide whether it is more likely than not that Fidelity Charitable made the promises alleged in the complaint. Other than the 10% daily trading volume promise, a promise that was kept, the court stated that the Fairbairns have not satisfied that burden.

Negligence Claim

The court then addressed the negligence claim whereby the Fairbairns contended that apart from the alleged promises it had breached, Fidelity Charitable's liquidation of the donated Energous shares violated the duty of care Fidelity Charitable owed to them. Thus, the Fairbairns asserted that, regardless of whether Fidelity Charitable breached legally binding obligations, its liquidation of the Energous shares was done in a negligent manner for which Fidelity Charitable should be liable for monetary damages.

In this regard, the Fairbairns insisted that a reasonably prudent investor in Fidelity Charitable's position would not have sold all 1.93 million donated Energous shares in the last two and a half hours of the last trading day of 2017. By engaging in such unreasonable trading, the Fairbairns' argued that Fidelity Charitable caused the price of the Energous shares to decrease, thereby lowering the December 29, 2017 average Energous share price and thus the amount of the Fairbairns' tax deduction, as well as the money available for donation in their DAF account.

In addressing the negligence issue, the court stated that recovery by the Fairbairns on a negligence claim depends as a threshold matter on whether the defendant had "a duty to use due care toward an interest of [the plaintiff's] that enjoys legal protection against unintentional invasion." Under California law, the court noted that the “general rule' is that people owe a duty of care to avoid causing harm to others and that they are thus usually liable for injuries their negligence inflicts." However, liability in negligence for purely economic losses is "the exception, not the rule. The primary exception to the general rule of no-recovery for negligently inflicted purely economic losses is where the plaintiff and the defendant have a "special relationship."

According to the court, a special relationship exists where "the plaintiff was an intended beneficiary of a particular transaction but was harmed by the defendant's negligence in carrying it out." "Discerning whether there is a special relationship justifying liability of this sort can nonetheless be a subtle enterprise." In addition to whether the transaction was intended to benefit the plaintiff, courts should consider the following:

- Foreseeability of harm to the plaintiff;
- Degree of certainty that the plaintiff suffered injury;
- Closeness of the connection between the defendant's conduct and the injury suffered;
- Moral blame attached to the defendant's conduct; and
- Policy of preventing future harm.

The court noted that deciding whether to impose a duty of care turns on a careful consideration of “the sum total” of the policy considerations at play, not a mere tallying of some finite, one-size-fits-all set of factors. In the present case, the court stated that the first two factors weigh in favor of finding the requisite special relationship here.

The court stated that the first two facts weighted in favor of finding the requisite special relationship here. The agreement to transfer the Energous shares to the Fairbairns' Fidelity Charitable DAF was intended to benefit the Fairbairns by giving them an immediate tax deduction while retaining the right to defer until a later date transferring the liquidated assets to the charities of their choice. The Fairbairns also had the right to pass on their DAF to their children. And, the court stated that it was certainly foreseeable that how Fidelity Charitable handled the liquidation could affect the Fairbairns by reducing their tax deduction and the amount of money in their DAF available for giving. But, as described above, the court stated that those two factors, alone, are not sufficient to find a duty of care.

In any event, the Court stated that it need not finally resolve whether Fidelity Charitable owed the Fairbairns a duty of care under California law under a special relationship it had with the Fairbairns, because the Fairbairns did not persuade the court that even if a duty was owed, that it was breached. Therefore, because the court found that Fidelity Charitable did not breach a duty of care in liquidating the Energous shares, the court declined to decide whether Fidelity Charitable even owned a duty of care to the Fairbairns in the first instance. Indeed, the court stated:

> While Fidelity Charitable did not the sell the shares to which it held legal title in the manner the Fairbairns—sophisticated hedge fund managers—would have done, and while in hindsight Fidelity Charitable might have handled the donation differently, ***the Fairbairns have not come close to proving that what Fidelity Charitable did violate the standard of care for a DAF under the anomalous circumstances of late December 2017***. (Emphasis added.)

The court also noted that when insisting that Fidelity Charity owed them a duty of care, the Fairbairns repeatedly argued that Fidelity Charitable could not simply "throw away" the Energous stock certificates. And their expert, Professor Brian Galle of Georgetown Law, testified that a soup kitchen charity with a donated golf course could not sell the golf course for pennies on the dollar just because the charity does not speculate on price. The court agreed, but stated that the evidence as to what happened with

Fidelity Charity's liquidation of the Energous stock on December 29, 2017 is leagues away from these examples.

COMMENT:

Fairbairn v. Fidelity Charitable is a fascinating case. The very premise of a fund being classified as a DAF for tax purposes under IRC § 4966(d)(2)(A), and the attendant tax advantages of a DAF over those of a private foundation, is that the fund be "owned and controlled by a sponsoring organization" and that the donor merely have "advisory privileges," not legally binding control over donated assets.

Yet, based on the decision in *Fairbairn v. Fidelity Charitable,* even where the donation is intended to fund a DAF, the donors may be able to impose legally binding promises on the sponsoring organization of the DAF, although the court in this case found that there was a lack of sufficient evidence for the donors to prevail on this issue. Although the court did not opine on whether a "special relationship" existed between the Fairbairns and Fidelity Charitable, it indicated that such a relationship could exist and, in such a situation, a sponsoring organization of a DAF could be held liable for a breach of a duty of care in connection with its negligent handling of the liquidation of donated securities.

Of note, it would also appear that had the Fairbairns been successful in asserting that Fidelity Charitable made legally binding promises in connection with their handling of the donated securities, the Fairbairns' fund at Fidelity Charitable would not likely have been considered a component part of Fidelity Charitable, but would have been treated for tax purposes as a separate and distinct private foundation, with all of the attendant tax consequences associated with a private foundation (as opposed to a public charity), at least as long as Fidelity Charitable's legally enforceable promises were in force. A much deeper discussion of this issue is provided in LISI Charitable Newsletter #300 by Richard L. Fox (August 31, 2020).

Fairbairn v. Fidelity Charitable raises important issues as to the effect of promises made by a sponsoring organization of a DAF and is a cautionary tale to sponsors of DAFs and donors alike. Both sponsoring organizations and donors alike should carefully consider the tax consequences of any agreement purportedly providing donors with legally enforceable rights, and sponsoring organizations should be prepared to abide by any rights provided to donors. Donors should also consider the effect of not retaining legally enforceable rights, given that the sponsoring organization would have ultimate control over contributed assets with the power, among other things, to liquidate donated securities in its sole and absolute discretion, subject only to the donors retaining non-binding advisory privileges.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Richard Fox

CITE AS:

LISI Charitable Planning Newsletter #307 (March 8, 2021) at http://www.leimbergservices.com

CITES:

Fairbairn v. Fidelity Investments Charitable Gift Fund, Case No. 3:18-cv-04881-JSC, U.S. Dist. Ct. N.D. Cal. (Feb. 26, 2021); LISI Charitable Newsletter #300 by Richard L. Fox (August 31, 2020)

CITATIONS:

[i] Case No. 3:18-cv-04881-JSC, U.S. Dist. Ct. N.D. Cal. (Feb. 26, 2021).

[ii] The court noted the following regarding the income recognized by the Fairbairns in 2017: "Nearly 20 years ago the Fairbairns founded Ascend Capital where they managed over $3 billion in funds. For the first seven years of the Fairbairns' hedge fund, they were able to avoid paying income tax on compensation earned from offshore funds. In 2007, however, Congress changed the tax laws to require repatriation by December 31, 2017 of the income sheltered abroad. On their accountants' advice, the Fairbairns decided they had to recognize all of that off-shore income—approximately $250 million—in December 2017, which would lead to a very large tax bill."

[iii] Like most sponsoring organizations of DAFs, the public charity status of Fidelity Charitable is under IRC §§ 170(b)(1)(A)(vi) and 509(a)(1).

[iv] DAFs have been part of charity for nearly a century, and have long been a staple of community foundations. Prior to the Pension Protection Act of 2006 (Pub. L. No. 109-208), the term "donor-advised fund" was not defined in the Internal Revenue Code or Treasury Regulations, but it was understood to include arrangements by which some charitable organizations (including community foundations) established separate funds or accounts to receive contributions from donors. DAF arrangements are comparable to component funds maintained by certain community trusts. IRS Donor-Advised Fund Guide Sheet Explanation (July 31, 2008).

[v] Under IRC § 4966(d)(1)(B), a sponsoring organization of a DAF must be a public charity, not a private foundation. The sponsoring organization is treated as one single entity for federal tax purposes and each of the DAFs within the sponsoring organization are considered to be a "component part" of such single taxable entity.

[vi] IRC §§ 4942 (5% payout requirement) and 4940 (1.39% net investment income excise tax).

[vii] For an extreme case (and clearly an outlier) demonstrating the lack of donor control over a DAF, see *Styles v. Friends of Fiji,* Nev. S.Ct. No. 51642 (2/8/2011), 373 P.3d 965 (2011), a decision by the Nevada Supreme Court addressing the issue as to what rights, if any, a donor has when the

sponsoring charity uses DAF funds other than based on the donor's recommendations and otherwise ignores donor recommendations. Although it determined that the charity in this case breached its duty of good faith and fair dealing by totally ignoring the donor's recommendations and using DAF funds only as its directors determined, the Nevada Supreme Court held that the donor was not entitled to any remedy because he had given up control over his contribution for tax purposes under a standard form of donor advised fund agreement.

[viii] IRC § 4966(d)(2)(A)(iii).

[ix] The court cited the following for authority: “CACI 1900, Civ. Code, § 1710 (1) (misrepresentation claim); CACI 303 (contract claim); Graham-Sult v. Clainos, 756 F.3d 724 , 749 (9th Cir. 2014) (promissory estoppel); Peterson v. Cellco P'ship, 164 Cal. App. 4th 1583 , 1590 , 80 Cal. Rptr. 3d 316 (2008) (UCL).”