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Securities/Antitrust Treatment of Charitable GiftAnnuities: Richie v. American Council on Gift Annuities, Inc.

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Summary

A lawsuit challenged, on both securities and antitrust grounds, the right of charitable organizations to issue so-called charitable annuities. Federal and state legislation to protect the charities was enacted. However, the Fifth Circuit has recently declined to review a district court's refusal to dismiss the case. The following Report briefly summarizes the theory of the lawsuit, the federal and state legislation which was enacted, and the recent decision by the Fifth Circuit.

Discussion

In 1988 a widow in Texas signed over assets to a religious foundation. The arrangement between the widow and the charity was a relatively common one: the widow was to receive from the charity a fixed amount of money at regularly scheduled times, and at her death the charity was to receive a lump sum distribution. This type of arrangement is often referred to as a charitable gift annuity.

Potential heirs of the widow brought suit in federal District Court in Wichita Falls, Texas, alleging violations of federal securities and antitrust laws.[1] The claim of the potential heirs that violations of federal securities laws occurred was based upon the

[1] Civil Action No. 7-94CV-128-X (N.D. Tex.). In May, 1997 a Federal District Court judge issued a partial summary judgment against the religious foundation, stating that it had violated state law by issuing charitable gift annuities without being licensed as an insurance company. In October, the judge agreed to expand the group of potential plaintiffs to include anyone who, from 1991 to the present, owned charitable gift annuities or related life income properties sold by the defendants. (Richie v. American Council on Gift Annuities) This defendant group reportedly would be comprised of more than 1500 charitable organizations, including the American Cancer Society, the Boy Scouts of America, and the Salvation Army.

argument that, because charities commingled a number of trust funds in a pooled income fund and because part of the funds' net earnings may be viewed as inuring to the benefit of persons and individuals, the charities should have registered with the Securities and Exchange Commission (SEC) as required by the Investment Company Act of 1940[2] and other federal securities laws.[3]

During the past twenty-three years, the SEC has addressed questions raised by charitable income funds. The SEC had provided no-action assurances[4] that charitable income funds could operate under certain circumstances without registering under the various federal securities laws. Despite these assurances concerning a particular transaction, a recipient could still have been liable to a private litigant who alleged that the same transaction violated federal securities laws. It is for this reason and certain other reasons, such as state securities registration requirements, that proponents of the bills discussed below believed that statutory exemptions needed to be granted under the federal securities laws for charitable income funds.

In the class-action lawsuit, the practice alleged to be violative of the antitrust laws as price fixing was the use by numerous charitable organizations of the annuity "payout rates" and actuarial tables provided by the American Council on Gift Annuities. Charities were also alleged to have engaged in deceptive trade practices by promoting themselves as "shrewd financial investors" who can offer optimum income options to "vulnerable" (the word used by plaintiff's lawyer) donors.

The Supreme Court has stated on several occasions, beginning with the Court's assertion of a "state action" exemption to the antitrust laws as a reason for not applying them to the States, that the purpose of the antitrust laws generally, and the Sherman Act particularly, has traditionally been to protect marketplace competition and *commercial* transactions from monopolistic or detrimental practices.[5] In *Parker* v. *Brown* and subsequent "state action" cases, the Court has made the distinction between private actions pursued for commercial, competitive gain and governmental actions assumed to be in the public interest.[6] Charities (nonprofits which are generally tax-exempt organizations) assert that since their activities are noncommercial they should not be subject to the operation of the antitrust laws. In addition, it should be noted that the defendant charities are not competitors of the individuals they are alleged to have harmed.

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[2] 15 U.S.C. §§ 80a-1 et seq.

[3] These other laws include the Securities Act of 1933 (15 U.S.C. §§77a et seq.) and the Securities Exchange Act of 1934 (15 U.S.C. §§78a et seq.).

[4] See, e.g., Investment Company Release No. 11016 (Jan. 10, 1980).

[5] Parker v. Brown, 317 U.S. 341 (1943).

[6] Parker, supra, note 5, is the decision in which the Court first enunciated the antitrust "state action" doctrine which has been repeatedly expanded over the past 50 years: "That [the] purpose [of the Sherman Act] was to suppress combinations to restrain competition and attempts to monopolize by individuals and corporations, abundantly appears from its legislative history." 317 U.S. at 351 (emphasis added). See, also, City of Lafayette v. Louisiana Power & Light Company, 435 U.S. 389 (1978), and subsequent "state action" cases.

Many commentators and jurists agree with that argument, although they recognize the question surrounding the antitrust treatment/analysis of noncommercial activities -- *i.e.*, whether all noncommercial activities should receive an unqualified exemption from the antitrust laws; or should be analyzed under the antitrust "rule of reason" doctrine (under which the anticompetitive results of a practice are balanced against any procompetitive consequences); or analyzed under the antitrust *per se* rule (under which only the occurrence of an antitrust-violative activity need be proved).

In *Missouri* v. *National Organization for Women, Inc.*, for example, the state unsuccessfully attempted to enjoin the organization's boycott of states that had not ratified the Equal Rights Amendment; the claim that the boycott constituted a "combination and conspiracy in restraint of trade" was rejected by the United States Court of Appeals for the Eighth Circuit, and the Supreme Court refused to hear an appeal from that decision.[7] Although the appeals court acknowledged that "an examination of the legislative history does not clearly indicate the answer to the question ... whether Congress wanted to protect `free and fair' competition from political or social activities that can have the same effect upon competition as the commercial activities of a trust against a business," it also noted that "Missouri does not direct us to, nor have we discovered any legislative history that indicates an affirmative intent of Congress to do so" (620 F.2d at 1305).

On the other hand, in two more recent cases, both the Supreme Court and the United States Court of Appeals for the Third Circuit found just such an intent: "There is no doubt that the sweeping language of [section 1 of the Sherman Act] applies to nonprofit entities ... and in the past we have imposed antitrust liability on nonprofit entities which have engaged in anticompetitive behavior";[8] "Congress ... intended [the Sherman Act] to embrace the widest array of conduct possible .... Section one's scope thus reaches the activities of nonprofit organizations [which] are not beyond the purview of the Sherman Act because the absence of profit is no guarantee that an entity will act in the best interest of consumers." The appeals court *did* note, however:

> [a]lthough nonprofit organizations are not entitled to a class exemption from the Sherman Act, when they perform acts that are the antithesis of commercial activity, they are immune from antitrust regulation. . . . This immunity, however, is narrowly circumscribed. It does not extend to commercial transactions with a `public service aspect.'"[9]

The House bills, H.R. 2519 (Philanthropy Protection Act of 1995) and H.R. 2525 (Charitable Gift Annuity Antitrust Relief Act of 1995), each passed the House unanimously on November 28, 1995; they dealt separately with securities and antitrust issues. H.R. 2519 permitted charitable income funds to operate without registering with the SEC under the Investment Company Act of 1940, the Securities Act of 1933, and the Securities Exchange Act of 1934. H.R. 2519 also provided further exemptions from federal and state securities laws to charitable organizations and persons associated with

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[7] 620 F.2d 1301 (1980), certiorari denied, 449 U.S. 842 (1980).

[8] National Collegiate Athletic Association v. University of Oklahoma, 468 U.S. 85, 101 (fn. 22) (1984) (note omitted).

[9] United States v. Brown University, 5 F.3d 658, 665, 666 (1993)(notes omitted).

these organizations concerning the maintenance and operation of charitable income funds. The legislation applied to actions pending on the date of its effectiveness in order to protect charitable organizations then being sued.

H.R. 2525 specifically allowed the practice alleged to be price fixing and, therefore, under antitrust attack in the Texas lawsuit -- the use by two or more nonprofit organizations of "the same annuity rate for the purpose of issuing [a] charitable gift annuit[y]." States, however, remained able to enforce their own antitrust-like statutes in this area, *if*, within three years from the enactment of H.R. 2525, they enacted statutes that "expressly provide" that the provisions of the federal legislation shall not apply.

S. 978 affected both securities and antitrust issues. The securities provisions of S. 978 were very similar to those in H.R. 2519. Its antitrust provisions were somewhat broader than H.R. 2525, granting an exemption from the antitrust laws for "the activities of a charitable organization relating to the issuance, maintenance, or investment of a charitable gift annuity." It, too, provided specifically for state enactment of statutes to prevent federal preemption of state law. S. 978 was not reported out of the Senate Committee on Banking, Housing, and Urban Affairs.

The House bills were enacted as the Charitable Gift Annuity Antitrust Relief Act, which provides that

> it shall not be unlawful under any of the antitrust laws, or under a State law similar to any of the antitrust laws, for 2 or more persons described in section 501(c)(3) of Title 26 that are exempt from taxation under section 501(a) of Title 26 to use, or to agree to use, the same annuity rate for the purpose of issuing 1 or more charitable gift annuities.[10]

Congress made this Act retroactive.[11] The Texas legislature also passed legislation intended to prevent state law claims by retroactively allowing nonprofit organizations to sell annuities and operate trusts.[12]

After passage of the new federal and state legislation, the plaintiff amended his complaint to add non-exempt defendants, such as law firms, insurance companies, and commercial banks, in essence alleging a hybrid conspiracy by exempt and non-exempt organizations. The district court again refused to dismiss the case.[13] Defendants petitioned to the Fifth Circuit for a writ of mandamus, requesting dismissal of both the state and the federal claims on the grounds that the district court abused its discretion by refusing to grant the second motion to dismiss, asserting jurisdiction to consider whether defendants meet the Relief Act's requirements for antitrust exemption, refusing to grant the first motion to dismiss, and refusing to enter summary judgment on the Texas state law

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[10] 15 U.S.C. § 37(a).

[11] P.L. 104-63, § 4.

[12] Vernon's Texas Banking Code Ann. art. 342-1113(3).

[13] Richie v. American Council on Gift Annuities, 943 F.Supp. 685 (N.D. Tex. 1996).

issues. Plaintiff requested that the court dismiss the defendants' appeals on numerous grounds, most importantly for lack of appellate jurisdiction.[14]

The Fifth Circuit held that it lacked jurisdiction to hear the appeal and imposed a $15,000 sanction on the defendants for pursuing a frivolous appeal.[15] In ruling that it lacked jurisdiction to hear the appeal, the Fifth Circuit stated that the district court's refusal to dismiss the case is not a final decision that can be appealed under 28 U.S.C. section 1291.

> It should be evident, from the above, that because the refusal to dismiss was predicated on Richie's claims of non-exempt defendants and a hybrid conspiracy involving them, the matters it addressed were neither conclusively determined nor separate from the merits of the case. To the contrary, the district court went out of its way to state that it would reconsider the defendants' claims of exemption as soon as there was sufficient evidence to do so. Given that the ruling was based on the possibility of a hybrid conspiracy, we need not consider whether the Relief Act grants § 501(c)(3) organizations some sort of immunity or right not to stand trial. It follows that because the denial of the motion to dismiss did not actually require a finding of no immunity, it is not a collateral order, and we lack jurisdiction to entertain the appeal.[16]

The court also held that it lacked jurisdiction to hear Northwestern University's claims for the same reasons that it lacked jurisdiction to hear the defendants' claims.[17] The court also denied defendants' petition for mandamus relief, finding that the grant of summary judgment by the district court was neither an abuse of discretion nor a usurpation of power, and the court found that the Texas Attorney General was entitled to intervene as of right. Finally, the court imposed sanctions for bringing an appeal that it considered frivolous.

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[14] Richie v. American Council on Gift Annuities, Inc., No. 96-11332, 1997 Westlaw 169400 (5th Cir. 1997).

[15] [T]he defendants ... have blithely ignored that Richie is alleging some of them to be non-exempt, which creates factual issues, and that he is alleging a hybrid conspiracy. Richie v. American Council on Gift Annuities, Inc., 1997 Westlaw 169400, *11 (5th Cir. 1997).

[16] Id., at *5.

[17] Northwestern University had separately appealed the denial of its motion for summary judgment, arguing that it had demonstrated its exemption under the Relief Act.