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PROCEEDINGS BEFORE

THE SUPREME COURT OF THE UNITED STATES

DKT/CASE NO. 85-599

TITLE UNITED STATES, Petitioner V. AMERICAN BAR ENDOWMENT, ET AL.

PLACE Washington, D. C.

DATE April 28, 1986

PAGES 1 thru 47

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IN THE SUPREME COURT OF THE UNITED STATES

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UNITED STATES :

Petitioner :

V. : No. 85-599

AMERICAN BAR ENDOWMENT, ET AL. :

- -x

Washington, D.C.

Monday, April 28, 1986

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 1:44 o'clock p.m.

APPEARANCES:

ALBERT G. LAUBER, JR., ESQ., Deputy Solicitor General, Department of Justice, Washington, D.C.; on behalf of Petitioner.

FRANCIS M. GREGORY, JR., ESQ., Washington, D.C.; on behalf of Respondent.

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C O N T E N T S

P R O C E E D I N G S

CHIEF JUSTICE BURGER: Mr. Lauber, I think you may proceed whenever you are ready.

ORAL ARGUMENT OF ALBERT G. LAUBER, JR., ESQ.

ON BEHALF OF PETITIONER

MR. LAUBER: Mr. Chief Justice, and may it please the Court:

These tax refund actions present two questions. The first is whether the American Bar Endowment, a charitable affiliate of the ABA, is subjected to unrelated business income tax on the profits it derives from running a group insurance program for its members.

The second question is whether the individual respondents, ABA members who acquired insurance from the ABA, are entitled to deduct a portion of their insurance premium as a charitable contribution.

Because Respondents were plaintiffs in a tax refund suit, they of course had the burden of proof. The Endowment conceded that its insurance activities were regularly carried on, and that those activities were unrelated to the accomplishment of its educational objectives. In order to avoid income tax on its insurance revenues, therefore, the Endowment was required to prove that the insurance operation was not a

trade or business.

Section 513(c) of the Code defines a trade or business as any activity which is carried on for the production of income from the sale of goods or the performance of services. Respondent agrees that its insurance operation satisfies every element of that definition in the statute, except for one that might be called the "from" test. The Endowment argued that its $5 million in annual insurance profits are not derived from the insurance goods that it sells or from the insurance services it performs.

QUESTION: Mr. Lauber, last week we had the all-events test. This week we have the "from test?"

MR. LAUBER: The "from" test. But that's what they argue. They argue that all this money they are making doesn't come from the insurance services that its staff of 40 perform during their working day, but rather, all the money comes from charitable fundraising.

Now, that argument in turn is based on their group gift theory which is the core of their case. The group gift theory starts from the premise that the Endowment sells insurance only to ABA members and the dependents of ABA members.

QUESTION: Mr. Lauber, if they sold it to the

public in general, what difference would it make?

MR. IAUBER: Well, they would then have a harder time making their group gift argument because their group gift argument, which is really the guts of their case, depends on selling only or largely to the organization's own members.

QUESTION: I suspect some arguments can be made the other way, that if the public in general were being solicited, that that would more clearly put them in the business community.

MR. IAUBER: I think they would agree with that, but their argument is because they only sell to members, they are different. And they reason that although they charge fair market, competitive prices for their insurance, they set their prices at a level that enables them to make fairly sizeable profits.

Now, they argue that their members, acting collectively, have the theoretical power to deprive them of any profits by forcing the Endowment to sell insurance at a lower price, at a price that would only cover its costs and let them make no profit at all. So they argue that all the profit they make comes at the sufferance of their members, and therefore, every dollar of profit does not come from the insurance business, but it comes from charitable fundraising in the form of a

group gift that the members make by refraining from requiring the Endowment to operate at cost.

The Claims Court accepted this group gift argument. It reasoned that the idea of a group profiting from its own members is almost a contradiction in terms, and the Claims Court held as a matter of law that an enterprise that depends on the consent of its members for its profits is not a trade or business.

This group gift theory, for which neither the courts below nor Respondent cites any authority or precedent, is wrong for four independent reasons. First of all, the group gift idea is foreclosed by the legislative history of the 1969 law in which Congress enacted its definition of the term trade or business. The House and Senate report accompanying that law discussed the group insurance activities of several categories of tax exempt groups, like fraternal beneficiary societies, such as the Knights of Columbus or Moose. These groups were authorized by the Code to provide insurance to their members and their dependents as part of their tax-exempt mission. That is, for these groups, the provision of insurance to members was a related function.

Both the House and Senate reports refer to these group insurance activities as a business but note

that those groups would be immune from tax on their insurance profits because for them the insurance business was related to their exempt function. For example, the House report wrote the bill excludes earnings from businesses related to an organization's exempt function, such as an insurance business run by a fraternal beneficial association for its members.

Now, these groups, like the Endowment, sold insurance only through their members and the dependents of their members. Thus, it was true for them as for the Endowment that the members had the theoretical power to deprive them of any profits at all by making a group gift. But the Congress nevertheless characterized those group insurance activities as a business, and this we think shows that the group gift idea has no place under Section 513(c).

Secondly, Respondents' group gift theory is foreclosed by three Courts of Appeals decisions that Respondent concedes to be correct. The Courts of Appeals for the Fourth, Fifth and Sixth Circuits have held that another category of tax-exempt group, that is, a professional association organized under Section 501(c)(6) as a business league, does run a trade or business when it provides insurance services and products to its members and their dependents. The

endowment makes no effort to distinguish its own insurance operation from the insurance operations of the groups in those other cases. Respondent agrees, in other words, that its full time staff of 40 people during their working day provide the -- perform the same kinds of promotional, administrative and marketing services and offer the same kinds of insurance products that the groups in these other cases offer.

QUESTION: May I ask about those cases, which I have not read? Are those cases in which there were dividends paid to the policyholders?

MR. LAUBER: The rebates to the -- I think in one of the cases there were dividends which the group did funnel through to the policyholders.

QUESTION: And the policyholder retained the dividend?

MR. LAUBER: Pardon me?

QUESTION: And the policyholder then retained the dividend --

MR. LAUBER: Retained the dividend.

QUESTION: Unlike this case where the policyholder must in effect contribute it to the Endowment.

MR. LAUBER: That's right. Those groups, those business leagues ran the insurance operation as a

service to members, more or less. There was one of the cases where the policy dividends came in to the group as an insurance experience rated reserve, and it did not distribute those to the members. But the compensations to the group took various forms, either a percentage of premiums or a reserve, experience rated reserve that came to the group. And the Courts held to the extent that the group held on to the money rather than distributing it out to the members, it was taxable on the income.

QUESTION: So here the difference, as I see -- maybe this isn't right -- from a typical program is that the dividends are all committed as a, they say as a gift. Of course, that's your second issue. But is it not fair to assume that if they didn't have that condition in the policy, that the "earnings," whether you call them earnings or -- anyway, the revenues of the Endowment, would be much less?

I mean, just talking on a straight business basis.

MR. LAUBER: Well, if they did what the IRS suggested, that they agreed to let the members have their dividends back and asked them voluntarily to donate the dividends back to the Endowment as a gift, the revenues only would be -- would be lower only if

members declined to make the contribution. Now, the Endowment is telling us how generous their members are. If that is true, the revenue should not be much lower under that mode of operation. But we think the fact that they require them to waive their dividend shows they really don't trut the generosity of their members, and are really running an insurance business, and the money must come to them in the form of insurance revenues, not from charitable contributions because they don't really trust their members.

I think that's what the case really comes down to.

In any event, the business leagues involved in these other cases which Respondent agrees to be correct could also have argued that because they only sold insurance to their members and the dependents of their members, that their insurance activity was not a trade or business but was simply a fundraising activity, and that the group was making a group gift to them.

However, all three Courts of Appeals held that those business leagues were in the trade or business, and Respondent agrees --

QUESTION: Was the deduction claimed in those cases as a charitable contribution or as a business deduction, the group, the "group gift" in these cases?

MR. IAUBER: It couldn't have been a tax deductible charitable gift because there are --

QUESTION: So it's different. So it's not really -- those were really --

MR. IAUBER: -- that all the profits they made were made at the sufferance of their members, because the members refrained from making them operate at cost, and therefore, whatever revenues they got were really a transfer from the group as a whole. It wouldn't have been a group gift, it would have been a group business deduction or something. But the same principle would apply, and those courts did not accept that principle. It wasn't argued.

Thirdly, the group gift idea Respondent suggests would open a loophole in the statute that Congress did not intend and which we think the language of the statute does not support. The Endowment's theory would enable any charity to run what would appear for all the world to be a trade or business, what would look and act like a trade or business, yet escape tax on its business profits simply by arranging to do most of its business with its members.

For example, a church could run a chain of ski lodges. As long as most of the skiers were members of the church, the church could argue that its members had

the theoretical power to deprive it of any profits, that all of its ski lodge income came not from the ski lodge business but from a charitable fundraiser.

QUESTION: But wouldn't they -- wouldn't all the skiers have to be members of the lodge for the example to be fair?

MR. LAUBER: Well, I think the premise of their argument is there has to be enough members in the customer base to give the members a real interest in trying to force the prices down. They wouldn't have to have all the members --

QUESTION: Kind of an unlikely church ski lodge, isn't it?

MR. LAUBER: Well, if the ski lodge, if the church --

QUESTION: If this is a big loophole, you ought to have a lot of examples that fit rather closely, and it doesn't seem to me this one fits.

MR. LAUBER: Well, it would, Justice Stevens, if the church only let members of the church go to the ski lodge.

QUESTION: Correct.

MR. LAUBER: But our position would be it would still be in the ski lodge business, even though only members were allowed to ski there.

QUESTION: I understand, but this is the dimensions of this big locphcle ycu're describing, these cases like this where all the members are also all the customers of the trade or business, isn't that right?

MR. IAUBER: Or where the group ccttd arrange cnly tc do it for members. You know, all these insurance cases involve plans that only are provided fcr members.

QUESTION: I understand. The lcophcle ccvers insurance plans, but really doesn't cover anything else.

MR. IAUBER: Well, it could cover any insurance plan where a, fcr example, say a university would set up a travel agency which would run Caribbean tours for alumni and faculty. They could argue that because all their customers were members that had the power to require it to lower its prices, that it wasn't in the travel agency business.

But you can imagine a lot of situations where ycu would have a group with a large membership base who might want certain services, and this group could provide it to the membership and claim it wasn't in a business simply because mcst of its customers were its own members.

We think this would open up a potentially

large loophole in the statute because many groups do offer services to their members. And the language of the statute, again, to go back to it, defines a trade or business as any activity carried on for the production of income from the sale of goods or the performance of services. The statute does not refer to the customer base of the business. There's nothing to suggest that a given group of activities would be a business in one case because of its customers yet would not be a business in another case because it had a different set of customers.

Finally, we think Respondent's group gift theory on its own terms doesn't make any sense. The cold fact is that the Endowment requires every insured to waive his claim to any policy dividends as an absolute condition of buying the insurance. It is simply part of the price of admission. The Claims Court accordingly held correctly, we think, that the individual respondents are not entitled to deduct any portion of their premiums as a charitable contribution because they had failed to prove that they paid more for the insurance than it was worth and that they paid any alleged excess with the intention of benefitting the charity. The Claims Court found that each individual Respondent in buying the Endowment's insurance was

pursuing only his own economic best interests.

Given the obvious nongift character of each of these transactions viewed individually, we think it makes no sense that viewed collectively they add up to some kind of group gift.

In closing I would like to make one point that might be called the --

QUESTION: Mr. Lauber, before you get to your closing, suppose this fund had been solely administered by the ABA and it was underwritten by an outside company.

MR. LAUBER: I think that would make our case even stronger because there -- the other side has argued they don't really sell insurance, that the underwriters sell the insurance, all they do is perform services in offering the insurance at retail. Now, if they were underwriting, too, it would plainly -- they couldn't even argue that they weren't selling insurance. But I think it would make no difference, although it would make our case that much stronger if that were true.

But the equities of this case have not been as apparent to the lower courts as they are to us, and we think the litigation below showed the government often has a hard time winning cases against charities, particularly where the charities are benefitting legal

education.

But I think our position is neither inequitable nor unfair. The IRS has made clear to the Endowment that the only thing they would have to do in order to avoid any income tax on their revenues is to agree to let the members have their dividends back. If the Endowment were to refund the dividends to the members and the members were then voluntarily and individually to donate the money back to the Endowment, it is clear, and the IRS has agreed that the members would then be entitled to a charitable contribution deduction and that that money would come into the hands of the Endowment as charitable receipts, not as business income.

The key question, then, is why doesn't the Endowment do that? If its members are as generous as they say, that should not produce a huge decrease in their revenues. The fact that they have refused to do that we think shows that they are not content to rely on charitable fundraising but want to run a business. That is why they are subject to tax.

CHIEF JUSTICE BURGER: Mr. Gregory?

ORAL ARGUMENT OF FRANCIS M. GREGORY, JR., ESQ.

ON BEHALF OF RESPONDENTS

MR. GREGORY: Mr. Chief Justice, and may it

please the Court:

The American Bar Endowment insurance program is today what it has always been, what it has been advertised to its members to be, and most importantly, for this Court this afternoon, what the Claims Court of the United States found it to be and what the Federal Circuit said the Claims Court was correct in finding. The United States Claims Court found as a fact that the Endowment's insurance plan was a charitable, fundraising effort under which members of the Endowment received insurance but knowingly, voluntarily and acting collectively surrendered to the Endowment for charitable purposes because they wanted to do so approximately the same amount of money that they had spent for insurance over the last 30 years.

In numbers, the Endowment has received $63 million from its members. The Claims Court found that the members intended this program to work as it did. Specifically, the Claims Court found -- and this goes to the first sentence of Mr. Lauber's argument today -- that the dollars we are talking about are not profits from a business. The Claims Court found as fact, and the Federal Circuit re-emphasized it at least three times in its opinion, that the dividends in question do not come from an activity that constitutes the sale of

goods or the performance of services.

After reviewing in detail the record over a month's trial, 25 witnesses, 3600 pages of testimony, more than 400-some-odd exhibits, the Claims Court said it was incredulous to find that lawyers would allow their association to exact from them, to force them to pay -- and this is the position of the Solicitor General, although we didn't hear it this afternoon -- that lawyers would allow their association to take from them unwillingly, and frankly, unwittingly, 100 percent in addition to what they would have had to pay for the very same insurance privately.

It's a finding of fact, plain and simple, and we invite the Solicitor General to address that point.

The Solicitor General suggests that there are four reasons why the group gift theory of the Endowment, as he puts it, has no relevance. Let me respond first by noting that virtually everything attributed to us, both in the brief of the government, in its reply brief, and at the oral argument today, is not our theory, it's not our view; we are simply expressing what the trial court found. The trial court found the facts.

It found that the dollars do not come from the sale of goods or performance of services. It specifically found that it was the intention of the

members to contribute to the charitable activities of the Bar. Let me quote the Federal Circuit at Appendix 12a to the Petition for Certiorari. In the present case the Claims Court specifically found that the assignment of dividends was not in exchange for services, but rather reflected the intention of the membership to support the Endowment's charitable activities.

QUESTION: You're on page 12a, Mr. Gregory?

MR. GREGORY: Yes, I am, Justice Rehnquist?

QUESTION: I can't -- well, perhaps -- it's in the petition?

MR. GREGORY: It's -- the Claims Court opinion is to be found commencing at page 2a of the petition, I believe, and according to my notes, the quote is at 12a.

I direct your attention to the footnote on 12a which is also quoted in our brief, Justice Rehnquist, at pages -- well, the whole footnote and a discussion of it is at pages 21 to 23 of our brief. About ten lines up from the bottom, "In the present case, the Claims Court specifically found that the assignmnt of dividends was not an exchange for services, but rather reflected the intention of the membership to support the Endowment's charitable activities."

The quotation, or excuse me, the statement was put into the footnote at this particular point by the

Federal Circuit to illustrate, to illustrate precisely that there is no difference between the plan of the Endowment under which members voluntarily contribute dividends and the situation hypothesized by Mr. Lauber whereby the Endowment, if it wanted to run a partially as distinguished from a wholly charitable plan, could have chosen to offer to refund dividends, footnote, would the government be standing by saying we still had a 501(c)(3) exemption, if we did?

QUESTION: If the point is so crucial, it is somewhat surprising to find it in a footnote.

MR. GREGORY: It's also found in the text, Justice Rehnquist, and if I could read what the Claims Court said which issued the initial findings of fact, this is page 41a of the Claims Court opinion, "It is quite obvious, then, that this money was not earned 'from the sale of goods or the performance of services,' but for some other reason. That reason was the intent of the members to support the Endowment's charitable activities."

In the text of the Federal Circuit opinion, the Court said that the Claims Court properly found facts and specifically found that the dollars in question do not come from the sale of goods or the performance of services.

I would suggest, Justice Rehnquist, that the two opinions below cannot be read in any manner other than as we have suggested to the Court that there was a specific finding of fact after looking at all of the evidence that the members did not pay for an exchange of services, either administrative services by the Endowment or for any form of insurance. They didn't have to.

The reason is quite simple. The members controlled the Endowment. The government has suggested time and again in its briefs and at oral argument that the Endowment has exacted or taken these dividends. That is not the finding of the Claims Court.

The Claims Court said, and if you would indulge me, I'd like to quote from pages 38a and 39a, "The final and most telling factor is that the insurance program was operated with the approval and consent of the ABA membership." Continuing a bit later in the quote, "Most professional associations (including almost all bar associations) operate such programs on a service-oriented basis and secure the most economical group insurance for their members. If the ABA had chosen to do this, it could have offered its members insurance at premiums lower than any other bar association, perhaps the lowest premiums of any group in

the country. The ABA members, however, have chosen a more generous approach, allowing the Endowment (rather than the ABA) to operate the insurance program and retain the dividends."

Now, the government from the beginning of this case, has taken the position and has offered the factual proposition that the members of the Endowment did not control the Endowment. We tried that issue. Numerous witnesses testified to that question. The Court considered it. The Court made a specific finding of fact with respect to membership control over this program. Again I would respectfully direct the Court's attention to pages 39a and 40a, also from the Claims Court opinion. I should also note that you find in the appendix of the Petition for Certiorari only the written opinion of the Claims Court. In our brief in response to the petition we noted that on two prior occasions the Claims Court had entered substantial and lengthy findings of fact. You will find them at the end of Volume 2 of the Joint Appendix, and we urge that they be read.

In the Claims Court opinion the Court said "Defendant suggests that ABA/ABE members have no control over the way the insurance programs are operated because the programs are maintained in their present form by an

unresponsive leadership. The court finds to the contrary. In the first place, there is nothing to suggest that ABA/ABE leadership is unresponsive to the wishes of the members they represent."

Later in the same paragraph the Court said, and I quote, "Plaintiff has demonstrated to the court's satisfaction that there are ample, effective channels within the ABA for members to make their views known and have them implemented."

I'd like to pause for just a moment to talk about the economics of this program, and to do so by way of illustration.

There is no question again that the findings on the record in this case are that the members of the Endowment on average, over 30 years, paid two times for insurance, what it was necessary the group to pay. Members of the Endowment so testified. The representatives of New York Life and Mutual of Omaha said that the insurance plan was available quite eagerly, in the words, I believe, of the New York Life representative, at any time the Bar chose to take it. What members have done, to illustrate, is to pay $200 for $100 worth of insurance and services. The Bar rendered the minimal services of being a group administrator, the same as every other professional

association renders, again made clear by the record, and more importantly, the findings of fact in this case.

The Claims Court asked itself, as it parsed the statute, why did lawyers pay $200 for each $100 of insurance? There are only two answers. One answer is that posited by Mr. Lauber today, and not simply the Solicitor General, I should say. It has been the theme of the government since this case started trial in October of 1983. The government says that the misinformed, the timid members of the American Bar Association have been bilked by their asscciation and tricked into paying $200 for each $100 of insurance they received. There is no other logical explanation besides a charitable motive.

The claim --

QUESTION: Are you now arguing, Mr. Gregory, the second part of the case, whether the members are entitled to take deductions, or are you arguing the unrelated business income part of the case?

MR. GREGORY: I'm arguing both parts of the case, Justice Rehnquist.

QUESTION: At the same time.

MR. GREGORY: To this extent we believe that the cases are inseparable as to this fact. The Claims Court after trial said I do not accept as a matter of

fact, I don't accept the witnesses, I don't accept any testimony. I find that the credible witnesses, the credible, factual position is that the members of the Bar were fully informed. The members of the Bar knew that they were paying twice as much for insurance.

QUESTION: But the Court of Claims found against you on the deductibility of the individual members, didn't it?

MR. GREGORY: The Court of Claims found against us, Justice Rehnquist, not because it had any disagreement with us as to the value of the professional association group insurance. It found against us because the Court of Claims adopted what the Federal Circuit described, we believe correctly, as a narrow test for determining charitable motivation on the part of an individual member.

And I can get to that now or I can get to it --

QUESTION: Well, suit yourself. I found it a little bit confusing because I wasn't sure which point you were arguing.

MR. GREGORY: Well, I appreciate the question because as to this fact, we're right on both points, and we think it's essential.

The Claims Court said I don't accept, the

trial judge, the explanation that members are misinformed. I specifically reject the government's position. I reject the government's position that the members don't control the Endowment. I find that the members control the Endowment. Because the members were well-informed, because the members controlled the Endowment, it is my finding that the Endowment has not received dividends because of the rendition of services or the sale of insurance; it's received them because of the charitable intentions of the members.

Let me turn to service, insurance, charitable contribution. All that the Endowment has done for 30 years is the very same activity group, other association group insurance plans have done either alone, as a group or in concert with third party administrators. Again, the record -- and I keep going back to the record. The government says we are ships passing in the night. We didn't pass in the night for 30 days at trial. We had a collision at sea, and findings were entered after that trial.

The value of the services rendered by the Endowment in this case were miniscule in comparison to the dividends received, approximately five to seven times in dividends what the record discloses the value of the services is. Indeed, the concededly deductible

expenses of the Endowment exceeded the value of the services. I don't believe there's any question about that on the record as well.

Turning to group insurance, what the member received. The member received professional association group insurance. Professional association group insurance is available to the members of the Bar at net cost. Net cost is premiums, less dividends, plus the attributable expenses of the Endowment. Again, I don't believe there's any dispute that the members of the Bar at any time they chose -- and they control the Endowment, as found by the Court -- could have chosen to have insurance for everything they paid except the dividends that went to charity. They could have taken the dividends, returned it to their pockets, tax-free both to themselves and to the Endowment.

The government in looking at the charitable contribution -- and to some extent we think this was the error of Judge Kozinski in the charitable contribution issue -- forgets that this record discloses three people who protested this plan in the form that it existed. Two testified at trial that they understood that it was a charitable program but they would have preferred that it be run at a cheaper price as a service to members because they didn't want to give up the dividend. One

person was referred to in the record who crossed out the dividend. It was not caught at the Endowment office. The dividend was refunded to him.

But the finding of fact is that the overwhelming majority of the members, with surprisingly little dissent, and I believe Chief Judge Kozinski said a handful of members only, objected to this program.

The government won't come to grips with the fact that this is a finding of fact, that the vast majority of the members wanted this program to work precisely as it did.

Group insurance is valued by well-known principles of law. It's valued by fair market value. What was the fair market value of what the members received. Fair market value is --

QUESTION: May I ask you a question?

MR. GREGORY: Certainly.

QUESTION: Maybe it's in the record.

What percentage of the membership of the American Bar Association subscribe to this insurance?

MR. GREGORY: The record reflects, Justice Stevens, that 57,000 members participated in the plan. The membership varied at times during the years in issue which were 1979 to '81, but it was no more than 300,000 members.

QUESTION: So about something like 20 percent of the association.

MR. GREGORY: I believe that the government and we have said that something in the order of 25 percent or perhaps a little less actually participated, but Chief Judge Kozinski found correctly that this plan was kept in place by members who did not participate as well as those who did. If you go back to my two hundred/one hundred example, if it were possible for the members of the Bar, as the Court found, to get insurance for $100 instead of the $200 they paid, those who did not participate made an economic sacrifice by allowing the Bar to operate solely a charitable fund.

Turning back to fair market value, if I might, of insurance. Fair market value is objectively determined. If you look at the regulations under Section 61, fair market value is the price at which a willing buyer and a willing seller, each having knowledge of the relevant facts and neither under a compulsion to buy or sell, will consummate a transaction.

Let's look again at what the Claims Court found. The Claims Court found that the members were fully informed as to the program. The Claims Court found that New York Life and Mutual of Omaha would have

provided this insurance to the Endowment at net cost. The value of the professional association group insurance is what it would have cost, what it could have cost the members who decided to pay more. That's a finding. The government cannot get around it. The members decided to pay $200 instead of $100, but that decision, the decision to take the $100 dividend, to remove it from the pocket where it could have gone tax-free, and to give it to charity, adds nothing to the fair market value of the insurance.

QUESTION: Well, if you're arguing the second point now, Mr. Gregory, I thought that the Claims Court had found against you on that point.

MR. GREGORY: The Claims Court found against us --

QUESTION: The Claims Court found that cheaper insurance was not available to three of the people, and although cheaper insurance had been available to the fourth, that person had not known about it.

MR. GREGORY: That is -- that is correct, Justice Rehnquist, looking solely at that particular individual, and let me explain what we perceive the error of the Claims Court to be and what the Federal Circuit said it was.

The Claims Court found that there were a

handful of dissenters, a very, very few, surprisingly little dissent I believe is the quote.

QUESTION: Well, now, these are Respondents that were testifying, not dissenters, according to the Claims Court.

MR. GREGORY: That is correct. The claims -- as to these Respondents, there was no testimony in the record as to what other insurance plans were available to them. At trial we urged a prophylactic rule, if you will. We asked the Claims Court, after it finished deciding the Endowment's case, to infer charitable motivation on the part of each individual by virtue of the facts found with respect to the Endowment's case.

The Claims Court said we will not make that inference. I find it necessary to look member by member as to whether there is charitable motivation. The Claims Court did not disagree with us as to what this group could have received insurance for. It said, however, and the Federal Circuit concluded that it did so erroneously, that in order to show charitable motivation, you have to show that you bypassed a cheaper, more economical insurance product in order to participate in the charitable plan of the Endowment.

The Federal Circuit reviewed that because we said it was error. On appeal we again said that on the

unique facts of this case, with the very little dissent and the findings that it made on knowledge, control and value of the insurance, the Court should infer uniform charitable motivation. The Federal Circuit declined to do so. Again, we don't contest that here. But what the Federal Circuit said is that the Claims Court has focused too exclusively and too narrowly solely on the -- on what would have been available as an economic choice. While this is relevant in the total calculus of the facts and circumstances test that is appropriate in a charitable contribution context, it is too narrow.

A charitable contribution looks not only at what was economically available to the individual at a particular time, it looks at a panoply of factors concerning motivation.

In addition, the Federal Circuit pointed out that we find somewhat surprising Chief Judge Kozinski's views in this respect since he didn't take into account the fact that the members, if they chose to do so, could have acted to receive back the dividends that went to charity. He disagreed with Chief Judge Kozinski as to the precise methodology, the Federal Circuit disagreed.

QUESTION: Does that mean that individual members could have received back the dividends that went to charity or that the membership as a whole could have

changed it?

MR. GREGORY: The membership as a whole could have changed the plan, Justice Rehnquist, and the finding is that the membership as a whole, which is nothing but the members, chose not to do so.

QUESTION: Well, how would that affect the intent to give or the donative intent of individual members?

MR. GREGORY: Well, let me give you an example? Let me hypothesize a trial concerning a charitable contribution. An individual comes in. The individual says I've been a member of the insurance plan for ten years. I have been told each year in a separate envelope that I have paid twice as much for this plan as was necessary and that the dollars left over, my dividends, according to my assignment, have gone to charity. When I received that notice I said to myself that's fine. I prefer it this way. I believe that this is appropriate. I am pleased as a member of the Bar to support the charitable purposes of the Bar, and I'm perfectly happy to pay the $200 instead of the $100.

We think that is an eminent illustration of charitable motivation.

QUESTION: It may be, but I don't see how the fact that the membership as a whole could have changed

it bears one way or the other on the motivation of the particular individual you've described.

MR. GREGORY: Well, the membership as a whole can be nothing but the sum total of the members. The alternative, Justice Rehnquist, is to posit a situation where 99.9 percent of the members have supported this program, as the Claims Court found, but then to say that because one-tenth of one percent objected, no member can come in and say I support it, I want it, and therefore I'm entitled to a charitable contribution.

QUESTION: Mr. Gregory, may I ask you a question?

MR. GREGORY: Yes.

QUESTION: It seems to me you're making two arguments, and I'm trying to sort them out in my mind. One is that an individual member, when he's advised that he doesn't, you know, he could get a better deal in effect, you are not saying he could then write in and say I want a refund. What he's doing, you're saying, by renewing for the following year, he in effect approves of the program. Is that the argument?

MR. GREGORY: Justice Stevens, it's often stated that in a group one votes with his feet.

QUESTION: Right. So individually they vote with their feet by keeping the policies.

But then the second argument was -- I'm not quite sure I followed. You say the membership as a whole has elected to make this charitable contribution.

What is the membership? Is it the 20 percent who have the insurance and are in the endowment, or is it the 100 percent of the American Bar Association?

MR. GREGORY: It's both, Justice -- well, it's the 100 percent of the American Bar Association, Justice Stevens.

QUESTION: So 100 percent decided to give away the money that belongs to 20 percent.

MR. GREGORY: That's what the government said at trial, but the Claims Court found that there was surprisingly little dissent, three people of record out of 57,000, and it drew the inference that the members of the entire organization wanted it to happen this way. It discussed the procedures for changing policies and positions of the American Bar, and it concluded that if a significant number of the members wanted a change, that issue would have been put up to the Bar. If the membership chose as a group to make the change, it would have been changed.

The -- for example, there's evidence in the record that not once, not once at an annual meeting of the American Bar Association or of the American Bar

Endowment has anyone proposed a change. If the will of the 80 percent, to take your numbers, had been imposed on the will of the 20, it's incredible that no one would have proposed a change.

QUESTION: I'm puzzled. There must be something, I'm sure there is a lot to the case I don't understand, but I'm puzzled as to why you don't argue more forcefully the fact that the 20 percent themselves, individually, are electing -- and presumably lawyers know what they're doing -- to take this unusually expensive insurance and thereby to make the contribution as they renew year after year.

Why isn't that sufficient?

MR. GREGORY: Well, I think it is, Justice Stevens.

QUESTION: That's not the theory of the lower court at all, is it?

MR. GREGORY: Well, I think if you look at our brief, which I know you have --

QUESTION: I've read the briefs.

MR. GREGORY: -- we say that. I mean, people, the member -- the member who chooses to take the insurance makes a choice. His choice is not to take the insurance. If he doesn't want it, he can go somewhere else.

QUESTION: But everybody is arguing about a group gift, and it seems to me that's an individual gift, and that's why --

MR. GREGORY: I think it's an individual gift made possible because there is a group that acting together can obtain this lower insurance.

QUESTION: And the government has conceded if you didn't attach the condition at the time of purchase of the policy but you sent them the dividend and they mailed it back, then there'd be no lawsuit.

MR. GREGORY: The government has so conceded, and we think they have conceded the case because of the findings of the Claims Court which we commend to this Court, that that's exactly what happened here.

In the few seconds remaining to me --

QUESTION: Now, Mr. Gregory, let's back up a minute.

MR. GREGORY: Yes, Justice Marshall.

QUESTION: Your point that the whole membership decides this, what procedure of the American Bar Association is for the whole membership to vote on anything?

MR. GREGORY: Mr. William Reece Smith, Jr. testified at this trial, Justice Marshall. He's a former president of both the ABA and the ABE. He

testified that any member may appear at the assembly of the American Bar Association, following protocol, giving notice, asking that a matter be taken up by the Assembly. The Assembly can vote on it. If the House of Delegates does not agree with the Assembly, then the matter is put to a mail ballot by all of the members of the ABA, and that is specifically set forth in the testimony in the case.

QUESTION: And how many times is that done?

MR. GREGORY: Well --

QUESTION: If ever?

MR. GREGORY: Oh, yes. The -- Mr. Reece Smith testified that he was overruled when he was president when he ruled out of order a motion to commend President Carter for supporting the controller's strike. It's been done. I cannot give you the specific incident -- specific incidents.

Legislative history, the legislative history referred to you by the government is covered in our brief. It's irrelevant. Congress was concerned about organizations running an insurance business. The Claims Court found we were not in a trade or business, we do not receive money from the sale of goods or the performance of services.

In the trade association cases, let me leave

you with one set of facts. In the three cases referred to by the government, the percentage of premiums received by these associations ranged from 2 1/2 to 7 1/2 percent. The Endowment received 40, 50, sometimes 90 percent of premiumes as dividends. Both courts below distinguished those cases, noting that the small percentages attributable to the trade asscciations were received from the sale of goods or the performance of services, and specifically rejected the conclusion that the members of the Bar had sat back for 30 years and allowed the Endowment to receive 40, 50 or 90 percent.

In conclusion, Chief Justice, members of the Court, this is a charitable program. There is no abuse. The members of the Bar have taken dollars that they could have returned to their pockets tax-free, and they have dedicated it to charitable purposes. If others choose to do the same, they ought to be encouraged. That's what Congress meant when it said charitable contributions should be enccuraged, and that's why a deduction is available.

If there are no other questions, thank you.

CHIEF JUSTICE BURGER: Do you have anything further, Mr. Lauber.

ORAL ARGUMENT OF ALBERT G. LAUBER, JR., ESQ.

ON BEHALF OF PETITIONER -- Rebuttal

MR. LAUBER: A few points.

Respondent argued at several points that what happened here is that the ABA members paid $200 for $100 worth of insurance. The Claims Court found to the contrary. The Claims Court found as a fact that the Endowment set its insurance prices at a level that was competitive with other insurance products available on the market, and the ABA itself did a study that was put into evidence that showed the cost of 20 state Bar plans was higher than the Endowment's cost and only four cost less.

As to the individual Respondents, the Claims Court found as a fact that each individual had failed to prove that he paid more than the fair market value of the insurance he applied for. The Claims Court accordingly held that there were no individual gifts made by the Respondents.

QUESTION: But Mr. Lauber, is it correct that there is this dramatic difference in the amount of the dividends, something like 40 percent in this program, and in the three cases you cite, there is about 5 percent or 2 1/2 percent?

MR. LAUBER: Well, the amount of the dividend is simply a function of the price that the Endowment charges. The higher the growth premium they charge, the

more the dividend.

QUESTION: Well, that tends to show they were paying close to $200 for $100 worth of services, then.

MR. LAUBER: But what, that $100 is part of the price they are charging for the insurance. They are charging $200 in premiums, and the Claims Court found the insurance was worth that.

Now, the reason the dividends are so high is because of the very favorable experience of Endowment members for health and illness and premature death.

QUESTION: Well, the real comparison then for someone wanting to save money would have been to have the Bar Association organize the same thing but on a noncharitable basis, rather than go to some other insurance company.

MR. LAUBER: Well, if the Endowment -- you mean the Endowment would just offer -- not make any profits.

QUESTION: If the American Bar Endowment insurance had not been designed to return any dividends but just to give lawyers the insurance protection at the minimum price, that would have been more favorable than the way it was set up. But other existing programs were not more favorable.

MR. LAUBER: That's right.

What they're comparing the price they actually charged to is what they could have charged had they chosen to make no profit, but that is not the fair market value of the commodity they were selling. The fair market value is what other competing insurance products sold for in the market. And the evidence at trial showed that it was -- the other competing products were more expensive than the Endowment's or about the same.

So what they are saying is that the value of what they are selling is what they could have charged had they decided to make no profit. That just begs the question. Every middleman marks up the products that he sells. That's how he makes money. And you can't say that the middleman's cost is the fair market value of the product he is selling. Look at the retail value of what he is selling. And here the evidence showed the retail value of what they were selling was comparable to other products in the marketplace.

QUESTION: Let me ask one other question.

In the cases in this area, generally we are concerned about the charity taking business away from the competing entities that would otherwise be getting the business. I take it the insurance industry is opposed to this program, there's evidence to that

effect, because they are the competitors who are being hurt?

MR. IAUBER: Well, they haven't filed an amicus brief on our behalf.

QUESTION: I hadn't noticed any, and I was just wondering what you would say about that.

MR. IAUBER: The competitors of the Endowment here most directly would be other groups offering group insurance to --

QUESTION: Like New York Life, would that be one of them?

QUESTION: No.

MR. IAUBER: No, New York Life is an underwriter. It would be groups like other state and local bar associations, legal fraternities, college alumni groups or anybody who is selling group insurance, credit card companies, oil companies. You know, every day in the mail you get letters offering to sell you insurance. All those people are competing for the same market that the ABE is.

Now, the Claims Court therefore found that none of the individuals had made gifts. The question then is whether all those little nongifts could add up to a group gift, and the Claims Court's finding that it did was not a finding of fact. That was a legal

conclusion.

QUESTION: I'm sorry, but I am really trying to learn something about this.

I gather there are a lot of exemptions in the insurance industry. You indicated earlier that a Moose or some of these lodges, are they competitors of this? Are some of the competitors of this type of insurance themselves the beneficiaries of specific statutory exemptions?

MR. LAUBER: Well, they could be. The thing is that they all sell insurance only to their members, so if there was some guy who was both a Knight of Columbus and a lawyer or member of the ABA, he would have insurance offered to him possibly both by the Knights of Columbus and by the ABE.

QUESTION: And the Knights of Columbus program is exempt by a specific --

MR. LAUBER: That's exempt.

QUESTION: Yes.

MR. LAUBER: But now there are other non -- many noncharitable groups who also are trying to sell insurance.

QUESTION: So the market we are talking about in which the competition occurs is at least partially exempt from taxation.

MR. LAUBER: Part of the market is partially tax-exempt, but a great deal of it isn't as well, credit card companies, American Express, VISA, all the rest of them.

Now, the Claims Court's conclusion that all of these individual nongifts added up to a group gift was not a findig of fact. That was a construction of the statute. The Claims Court held as a matter of law that an enterprise that depends on the consent of its customers for its profits is not a trade or business. That was not a finding of fact. That was a conclusion of law.

So we think that this group gift idea is supported by no findings of fact, simply a notion that the ABE put into Judge Kozinski's head. And we think that must be evaluated as a legal matter, not as a factual one.

Now, most of what Respondent refers to as findings of fact are irrelevant as a matter of law. They keep saying that the Claims Court found they were not in the business, that that is the ultimate legal question, is this a trade or business as defined by the statute, Section 513(c). That's not a finding of fact.

The keep saying that, well, the Claims Court found that people who bought the insurance wanted to aid

the Endowment's charitable endeavor. That is also irrelevant as a matter of law. People who bought spaghetti from NYU's Muller Macaroni Company rather than from Ronzoni may have wanted to help out NYU but didn't put -- didn't mean they were not in a trade or business of selling spaghetti. The intent of the members is simply irrelevant. The question is whether the Endowment was carrying on an activity for the production of income from the sale of goods or the performance of services.

Now, the group gift idea we think not only doesn't make any sense as a legal matter, but practically speaking, the members of the ABA, although there are -- they can be convened, the fact is that only 20 percent of ABA members buy the insurance. The 20 percent -- the 80 percent who don't buy the insurance don't care probably what the 20 percent are charged. They don't mind that they are charged a price that enables the Endowment to make a lot of money. What this really amounts to is a form of noblesse oblige under which the majority have the nobility and the minority the obligation.

CHIEF JUSTICE BURGER: Thank you, gentlemen. The case is submitted.

(Whereupon, at 2:38 o'clock p.m., the case in

the above-entitled matter was submitted.)

CERTIFICATION

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#85-599 - UNITED STATES, Petitioner V. AMERICAN BAR ENDOWMENT, ET AL.

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BY Paul A. Richardson

(REPORTER)