

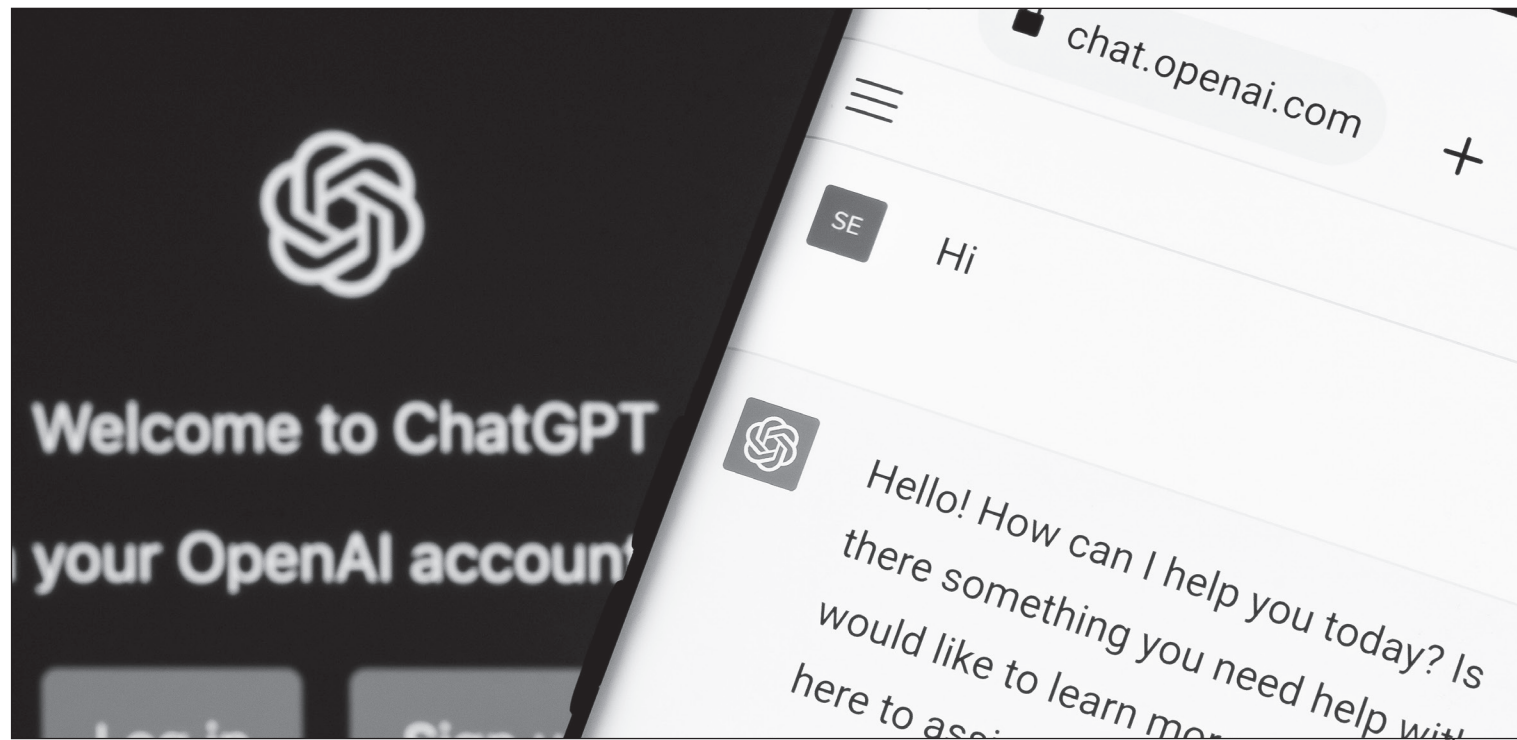
OpenAI's structure raises questions about protecting its charitable mission

By Rose Chan Loui

In the latest development in the OpenAI saga, Elon Musk has, for the second time, sued the group of entities known as OpenAI, this time in federal court in northern California. Musk complains that OpenAI abandoned its purpose of developing artificial intelligence that benefits humanity. Musk, an original co-founder of OpenAI, Inc., had filed a similar suit in California state court in February 2024, which he quietly dismissed in June 2024. This complaint is more detailed, alleging violations of RICO, fraud, breach of contract, false advertising, and breach of fiduciary duty.

The creator of ChatGPT, OpenAI became front-page news in the business and legal world when its board fired founder and CEO Sam Altman, reportedly for lack of candor in his communications with the board. After an outcry from investors, including Microsoft and OpenAI's own employees, Altman was returned to his CEO position, and the board was reconstituted with people perceived as friendlier to Altman. The ousting and return of Altman highlighted the fact that the parent company at the top of the OpenAI structure is a tax-exempt, nonprofit entity, with a board charged with protecting its charitable mission. While not uncommon for nonprofit organizations to own and profit from for-profit subsidiaries (e.g., Patagonia and Newman's Own), the value (reportedly \$80-90 billion) of OpenAI's for-profit operations and the extent of external investment in those operations may be unparalleled, raising the question whether OpenAI's carefully designed structure can adequately protect its charitable mission.

The parent entity, OpenAI, Inc. ("Nonprofit") is a tax-exempt, nonprofit company organized in Delaware in 2015. Per its certificate of incorporation, Nonprofit's purpose is to provide funding for research, development, and distribution of



technology related to artificial intelligence. Nonprofit states in public filings that its goal is "to advance digital intelligence in a way that is most likely to benefit humanity as a whole, unconstrained by a need to generate financial return." Because it operates in California, Nonprofit is registered as a charity with, and subject to the oversight of, the California Attorney General.

In 2019, the board of Nonprofit determined that donations were insufficient to achieve the company's charitable purpose of developing AI. Having raised through philanthropy only \$130 million of the \$1 billion needed, they sought a structure that would allow for private investments. According to the OpenAI website, the structure was expanded as follows: Nonprofit formed Open AI, LP, to be owned by Nonprofit, employees and other investors but governed by Nonprofit and operated in accordance with Nonprofit's charitable purposes. Open AI, LP would have a subsidiary, OpenAI LLC ("For-Profit"), in which Microsoft would have a 40% profits interest. Under this structure, Microsoft has reportedly

invested over \$10 billion in OpenAI. According to Musk's complaint, the structure may now contain more entities than are described on the OpenAI website.

OpenAI's website describes various features of the investment structure that are intended to align investors' motives with Nonprofit's mission. First, Nonprofit wholly owns and controls the manager entity (OpenAI GP LLC) that controls and governs For-Profit. Second, Nonprofit's directors are required to perform their fiduciary duties in furtherance of Nonprofit's mission to produce safe AGI (Artificial General Intelligence). Third, the board remains majority independent, with "independent" defined as not holding equity in OpenAI. Fourth, as stated above, profit allocated to investors and employees, including Microsoft, is capped, so "all residual value created above and beyond the cap will be returned to the Nonprofit for the benefit of humanity." Fifth, the board determines when OpenAI has attained AGI, which OpenAI defines as "a highly autonomous system that outperforms humans at

most economically valuable work." Notably, OpenAI's commercial agreements with Microsoft apply only to pre-AGI technology.

From the nonprofit law perspective, one question is whether, with For-Profit being valued at \$80-90 billion and both employees and outside investors "invested" in that valuation, these features will succeed in protecting the charitable mission. First, while OpenAI boasts that Nonprofit's board of independent directors will protect the mission, OpenAI defines independence as equity ownership. Other interests, such as Microsoft's profits interest, don't count. Neither do economic interests in partners of For-Profit. Musk's complaint alleges that Altman has significant interests in various companies that have profitable business relationships with OpenAI. If this is true, Altman doesn't need a direct equity interest in For-Profit to have an interest in its profitability. Second, one of the board's key responsibilities is to determine the complex question of whether AGI has been achieved and to ensure that the path to AGI development is safe for hu-

manity. There is no general agreement on how to define AGI, and the academic and public policy board members who arguably had the expertise to determine whether AGI was being developed safely, or had been achieved, have left. Further, key employees who have left (e.g., former chief scientist Ilya Sutskever) say OpenAI is prioritizing profit over safe development of AGI, indicating there is internal disagreement about OpenAI's commitment to its nonprofit mission. Moreover, no board is immune to pressure from its donors, or in this case, its investors. Since Microsoft's profits interest is limited to pre-AGI technology, the structure is incentivized to delay public acknowledgement that AGI has been achieved. Third, although the "capped-profit" structure would seem to ensure that Nonprofit benefits from its ownership and control of For-Profit, some wonder whether 100x investment is a cap at all. For some context, Nvidia, a prominent AI stock, has risen around 30 times in the last five years. Although some early-stage tech companies can do better than public companies like

Nvidia, very few companies make 100x their investments, and in this case, Microsoft alone has invested over \$10 billion. Further, we do not have insight into how much other outside investors have invested in For-Profit, and as far as we know, there is no limit on how much additional investment OpenAI can accept.

There is certainly more to come in this saga. Altman has told some investors that OpenAI may become a for-profit benefit corporation (like rivals Anthropic and xAI), which would not be controlled by Nonprofit. That raises the issue of what the Nonprofit would be entitled to in a conversion. In comparison with the \$80-90 billion dollar valuation of For-Profit, the Nonprofit showed assets of \$19 million (consisting of cash, savings and cash investments) in its 2022 filing with the California AG. As more transparency is gained, perhaps through investigations by the Federal Trade Commission (in collaboration with the Department of Justice) and the European Commission, as well as Musk's lawsuit, we may be better able to judge whether this nonprofit/for-profit structure will succeed in serving its lofty charitable purpose of developing artificial intelligence for the benefit of humanity.

Rose Chan Loui is founding executive director, Lowell Milken Center on Philanthropy and Nonprofits at UCLA School of Law.



Legal and political battles threaten Medicare drug price negotiation program

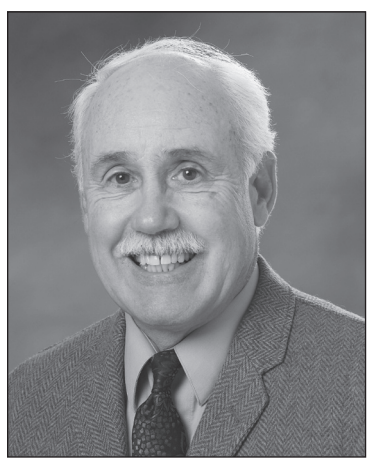
By John H. Minan

In August 2022, President Joseph Biden signed the Inflation Reduction Act (IRA), which among other things created the voluntary Drug Price Negotiation Program. It is designed to rein in the high cost of certain single source, high-priced drugs for Medicare beneficiaries and the taxpayers by using the federal government's purchasing power with drug manufacturers.

The program is expected to save billions of dollars for the government and beneficiaries. Prior to the IRA, Medicare was prohibited from negotiating drug prices with manufacturers due to lobbying by the pharmaceutical industry.

The law authorizes the Secretary of Health and Human Services (HHS) to establish a Drug Price Negotiation Program aimed at limiting the cost of certain drugs under Medicare. The Secretary has delegated this negotiating authority to the Centers for Medicare and Medicaid Services (CMS). CMS is required 1) to publish a list of drugs, 2) enter into agreements with the manufacturers of those drugs, and 3) negotiate and, if ap-

John H. Minan is a professor of law emeritus at the University of San Diego and former attorney with the Department of Justice in Washington, D.C.



plicable, renegotiate maximum fair prices for the selected drugs.

On Aug. 15, the CMS published the maximum fair price agreed to with the drug manufacturers for the first round of 10 eligible drugs. The savings are significant (See below, CMS list of 2026 projected savings). For example, AstraZeneca's diabetes drug Fxaxiga will be reduced 68% starting in 2026. By March 2025, CMS will make public an explanation of the agreed upon maximum fair prices. Those prices negotiated for the selected drugs become effective on Jan. 1, 2026.

The IRA provides that "[t]here shall be no administrative or judicial review" of the determination of which drugs are negotiation eligible, the selection of drugs for the negotiation program, or the final selected maximum fair price.

Manufacturers that violate certain statutory requirements after signing a manufacturers agreement "are subject to a civil monetary penalty" (42 U.S.C. § 1320f-6(a)). Manufacturers that do

not sign an agreement or agree to the maximum fair price are subject to an excise tax on the sale of the selected drugs. But a manufacturer that wishes to avoid these consequences is free to withdraw its products from the federally supported program. Thus, the program is voluntary because manufacturers are not forced to sell drugs to the federal government.

Drug manufacturers and their allies have brought a wave of lawsuits challenging the law. The Health Policy and Law Initiative at Georgetown University's O'Neill Institute, Health Care Litigation Tracker, identifies 15 lawsuits that raise a range of constitutional, statutory, and agency challenges. The constitutional challenges include allegations that the negotiating program violates the First Amendment, the Fifth Amendment (Due Process and Takings), and the Eighth Amendment (Excessive Fines), the nondelegation doctrine, and the enumerated powers doctrine.

Three cases, for example, are

pending in the Third Circuit where briefing is ongoing: *Janssen Pharmaceuticals v. Becerra et al.* (24-1821); *Bristol Myers v. Bacerra et al.* (24-1820); and *AstraZeneca v. Becerra et al.* (24-1819). To date, various district court judges have expressed skepticism on the merits of the legal arguments advanced by the pharmaceutical industry and its allies.

But that could change as the cases move through the legal system and presumably up the judicial ladder toward the Supreme Court. In addition to the pending legal challenges, it is worth recalling the strong political opposition to the IRA. Senate and House Republicans all voted against the law and Vice President Kamala Harris' vote was needed to break the tie in the Senate.

Republican opposition is also embedded in the Heritage Foundation's Project 2025 "Mandate for Leadership," which has been called the "administration-in-waiting" policy for former President Donald Trump should he be reelected in Novem-

ber. On page 465, the Project author Roger Severino clearly states the "negotiation" drug pricing program "should be repealed." Severino served as the director of the Office of Civil Rights at HSS during the Trump Administration.

The legal challenges to the IRA

price negotiation provisions now being aggressively litigated by the drug manufacturers would be mooted should the law be repealed. This would harm Medicare enrollees as well as taxpayers. Democracy cannot endure unless those who vote are prepared to choose wisely.

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