Autopsy of a Gift Gone Bad: Lessons Learned[1]

Prologue: *If you torture the numbers long enough, they'll confess to whatever you want them to say.*[2]

I first heard that pithy quip as a graduate student at the Ole War Skule many moons ago. Even though this quote could be called crass pessimism, it nevertheless has been time and again one of the immutable truths in my life. Nefarious people whose aim it is to separate a poor unsuspecting chap from his capital will stop at nothing to prove their point numerically that what they have to offer is a "great deal," so caution always is advised. And that may be the overarching lesson of this case.

This article does a deep dive, a literary "autopsy" if you will-into a reported decision that is over 18 years old. A fair question is why? I offer two more quotes:

A generation which (sic) *ignores history has no past—and no future.*[3]

When I want to understand what is happening today, I try to decide what will happen tomorrow, I look back, a page of history is worth a volume of logic.[4]

But this isn't just going to cover the reported decision; it's going to discuss the *rest of the story*.[5]

A Little History:

History indeed teaches many valuable lessons, and, quite often, that lesson is what goes around comes around. In this current era (at least until the next federal election cycle) of so-called permanent reform of the death tax, it is even more important than ever today to remember the **income tax** aspects of wealth transfer, which still applies to about 50% of U.S. taxpayers (approximately 44.4% of U.S. taxpayers paid no federal income tax in 2018).[6]

Since its enactment back in 1913, U.S. taxpayers have aggressively looked far and wide for income tax relief. Some estate planning techniques will remain popular with the "other 99.6%" for their income tax savings potential even after estate tax effective repeal. The charitable remainder trust is one of these techniques because it offers a way to diversify appreciated property without having to pay the capital gains tax upfront, thereby allowing the taxpayer to continue to earn a return on the entire net sales price, unreduced by income taxes. I believe that as interest rates continue to tick up, there will be increased use of charitable remainder trusts. Therefore, the lessons of this case may be needed now more than ever before. Indeed, what goes around comes around.

Introduction of the Case:

The subject case in question, *Martin v. Ohio State University Foundation, et al.*[7] involves a set of facts that could have happened to *any* charity: a net income with makeup charitable remainder unitrust ("NIMCRUT")/wealth replacement insurance policy gone bad.

The very first thing to note about this case is the identity of the *first named defendant.* The Foundation was immortalized in a way that few desire. This is another lesson of the case: charitable organizations must be so far above the appearance of impropriety that we are beyond reproach.

As my favorite boss of all time[8] beautifully puts it: *when the proverbial s___ hits the fan, we in charitable organizations are in the front row wearing white linen suits*.[9] Why? It's because charitable organizations usually have deep pockets and benefitted from the gift in some way. Stated differently, the efforts of representatives of charitable organizations often get scrutinized after the fact. And our efforts can be easily misconstrued after the fact or be painted with the dark brush of greed and self-interest.

Hermeneutic for evaluating and designing estate and charitable planning tools:

The proper evaluation and design of an estate and charitable planning technique involves a three-part consideration:

- factors peculiar to the ***technique*** itself, i.e., the essential nature of the technique

- factors peculiar to ***assets*** that may be involved or affected by the technique
- factors relating to the **“players”**, i.e., persons (including the client or donor) who are involved in or potentially affected by the technique

Many incidents of failure or underperformance in estate planning can be directly attributed to incomplete or inaccurate evaluation or design of an estate or charitable planning technique. In other words, one or more of the legs of the estate or charitable planning “stool” was weak. The reasons for poor technique evaluation or design often involve a mismatch between the players, the assets or the techniques, e.g., a players-techniques mismatch or a techniques-assets mismatch.

There are many subtleties and counterintuitive factors involved in the process of selecting and designing techniques. Thus, the goal in technique selection and design is the best long-term ***fit*** between the asset, the technique and the players. A secondary goal is to implement a technique that does not have a negative effect on the client and the players, a gesture toward Hippocrates’s advice to physicians in *The Epidemics* to "do no harm."

The Players.

These were the parties to the lawsuit.

The plaintiffs: Raymond, age 65 and uninsurable, and Margaret Martin, age 59, had annual pre-tax income of approximately $24,000 and limited cash reserves. However, what the Martins had was a piece of potentially valuable real estate. More about that in a bit.

The Defendants: The Ohio State University Foundation (“Foundation”)-Beneficiary/Trustee/Defendant-settled for $675,000 by buying the Martins’ income stream from the NIMCRUT in 1998, collapsing the NIMCRUT.[10]

William Clark ("Clark")-Insurance Agent-Financial Planner who sold the life insurance policy that was supposed to replace the wealth lost on termination of the NIMCRUT/Defendant/Appellee.

Dennis Clark and Associates Agency, Inc.-General Agent for Great West Life Assurance Company/Defendant/Appellee.

Great West Life Assurance Company-Insurance company that sold the policy/Defendant/Appellee.

The Property:

The Martins' most valuable property was 3.84 acres of encumbered, non-income producing commercial real estate on Sawmill Road close to Columbus OH that the Martins had acquired in 1956 ("Sawmill Property"), in which the Martins had a very low adjusted basis for income tax purposes. Prior to 1985, the Sawmill Property had been zoned as rural farmland of very modest value. However, after rezoning in 1985, the property's value allegedly increased significantly, and with it, the Sawmill Property's ad valorem taxes, further financially strapping the Martins, who put the Sawmill Property up for sale in 1985.

The Sawmill Property was highly appreciated. The Martins soon engaged in the "developer's option dance" for two years, where a developer paid them $5,000 per month for an option to acquire the property, but the property didn't sell at the end of the two-year option period. As a result, the Martins found themselves once again saddled with increased ad valorem taxes but no quick way to sell the Sawmill Property.

The Timeline:

The timeline of events in this case is fascinating. My comments follow below each entry.

August 1989-Clark spoke to the Martins' son and learned that the Martins wanted to sell the Sawmill Property and retire to Florida or Arizona.

Comment: Note that the insurance agent got the lead on the Martins from their son.

August-December 1989-Numerous meetings between Clark and Raymond, during which it is determined that, with the aid of a software program named ProPlan, a NIMCRUT combined with a wealth replacement life insurance policy (the "Strategy") was the proper route for the Martins. At this time, it seems to have been decided that the Foundation should serve as trustee and beneficiary, even though it doesn't appear that the Foundation had yet been brought into the loop.

Comment: In hindsight, at this point, the Martins were less than one year away from forming a NIMCRUT with a significant portion of their collective net worth, yet the Foundation doesn't seem to have been brought in until after the decision to proceed with the Strategy had been made. In my opinion and experience, this is highly unusual and certainly contributed to the difficulty here. From and after that point, Fellows probably would have been well advised to have pursued a relationship with the Martins outside of the watchful eyes of Clark and Wolfe. Many of the actions that Wolfe and Clark took were consistent with those seen in an undue influence case, e.g., isolation, managed communications, etc.

December 1989- Raymond met with Fellows, who gave the Martins a brochure entitled "Charitable Reminder Unitrusts" and a videotape about the subject, which Raymond believed backed up what Clark and Wolfe had told him about the Strategy.

Comment: Remember that every piece of marketing literature that you put out could come back to haunt you as exhibit A to a law suit against you. Perhaps a separate marketing piece for NIMCRUTs might have helped because the point of no distributions before sale of the NIMCRUT property perhaps could have been more clearly made. Fellows would have been well served by meeting or communicating with the Martins **outside of the presence** of Wolfe and Clark and building a relationship with them independent of the advisors that Fellows himself had described as **mercenaries** to get an unfiltered message to the Martins. In my opinion, that was sorely lacking and the probable reason why the Foundation settled for such a significant amount.

April 1990-Clark contacted Hertenstein and directed him to draft the NIMCRUT, even though Hertenstein never talked to Raymond until the day that the Martins executed the NIMCRUT, on August 16, 1990.

Comment: In my opinion, Hertenstein was damn lucky that he wasn't a part of the collateral damage in this matter and didn't get sued too. This is probably because the work product, a NIMCRUT instrument, was correctly done. The NIMCRUT was exactly the wrong tool for the Martins and their property. **A perfectly drafted document actually harmed the Martins in this instance.** Let that sink in for a minute. I believe all estate and charitable planners also should subscribe to that part of the Hippocratic oath that implores physicians to "do no harm."

May 1990-Fellows and Raymond **negotiated** the agreed-upon value of the Sawmill Property, $1,262,500, as well as the NIMCRUT seven (7%) percent payout rate.

Comment: Originally, the Martins asked for 8% NIMCRUT payout, but Fellows and Clark talked them down to 7%. The appellate court opinion was silent as to whether appraisal was made of the Sawmill Property, which clearly would have been required for income tax substantiation purposes.[11] Fellows should have taken every effort to make certain that the Martins knew that there would be no NIMCRUT distributions until sale of the Sawmill Property, especially given that Fellows viewed Clark and Wolfe as mercenaries. In my opinion, Fellows' passive behavior probably hurt the Foundation here.

June 1990-At Clark's request, Fellows faxed Wolfe an internal solicitation memorandum for the NIMCRUT, on the last page of which Fellows wrote that there would be no distributions from the NIMCRUT until the trustee sold the Sawmill Property. However, Clark never showed this to the Martins.

Comment: The plot thickens. The testimony adduced at trial conflicted here, but Raymond was certain that he never saw that memorandum.

July 1990-Clark and Wolfe gave the Martins a document entitled "Estate Planning Ideas for Raymond and Margaret Martin," which set out only two plans: (1) An installment sale of the Sawmill Property by the Martins themselves, which resulted in $48,160 for 24 years, with nothing left at the end of that period (which they called a "bad plan"); and (2) the Strategy, which paid $96,000 per year, increasing 3% per year, **beginning immediately (no prorated first year payment)**, and the annual insurance premium was $39,810.

Comment: The appellate opinion indicates that Wolfe had the Martins fill out a questionnaire at the outset, the answers to which must have suggested a NIMCRUT. I seriously doubt that this questionnaire's answers had any real effect on the Strategy, which seemed to have been to sell a $1,000,000 quick pay life insurance policy on Margaret's life, with the NIMCRUT as the insurance funding mechanism, instead of the other way around, as it should have been in my opinion.

An installment sale over 24 years to an unrelated third party? Really? That would have been against the advice of just about every experienced tax and business lawyer that I know. Cash is king, particularly for a third party sale. Incredibly, the projections in the installment sale option were that there was no growth of the sales proceeds received, as they assumed, rather curiously, that all would be spent during the period without any evidence to back that up.

In my opinion, this was nothing more than a predetermined result. That they presented only two plans ultimately was a huge problem for Clark and Wolfe. Did they forget **do nothing** as a plan, i.e., maintenance of the status quo ante? Query whether Clark and Wolfe were merely sloppy in not prorating the first-year NIMCRUT distribution as they had in the past, or whether they were just being duplicitous.

July-August 1990-Clark and Wolfe gave the “memorandum” to Fellows, who commented on Item 4 that the NIMCRUT wouldn’t make distributions until it sold the Sawmill Property, but Clark redrafted the memorandum without Item 4 and gave that to the Martins.

Comment: Res ipsa loquitur.

July-August 1990-Clark and Wolfe delivered to the Martins a document entitled A Retirement and Tax Planning Summary for Raymond and Margaret Martin, which reflected that pursuant to the Strategy, the NIMCRUT would distribute $21,000 in 1990 (year of formation), $84,630 in 1991, and increasing thereafter.

Comment: Note that Clark and Wolfe did manage to properly illustrate the partial first year NIMCRUT payment, although, again, it intimated that distributions would commence **immediately**, which belied the truth.

August 16, 1990-Martins begin implementation of the Strategy by selling an undivided 1/5 interest in the Sawmill Property to the Foundation for $225,000, which was used in part to retire the debt and cancel the mortgage, and they contribute the remaining undivided 4/5 interest to the NIMCRUT, and Raymond didn’t see the NIMCRUT instrument until the closing.

Comment: In my opinion, it was unconscionable that the Martins didn’t even see the NIMCRUT instrument until the day of the closing.

After August 16, 1990-Great West issues a $1,000,000 life insurance policy on Margaret’s life at an annual premium of $45,144.36 for five years, and the Martins pay the insurance premium and make a down payment on Florida real estate, thereby virtually exhausting their cash reserves in reliance upon the promised immediate NIMCRUT distributions.

First quarter 1991-the Martins find out from Fellows and Clark that the NIMCRUT wouldn't make any distributions to them until the Foundation sold the NIMCRUT's interest in the Sawmill Property.

Comment: Ruh Roh.

1991-Because they had no more money, the Martins quit paying the insurance premiums, but Clark advanced the premiums for six months, after which the Martins requested that the insurance coverage be reduced to $250,000. The Martins ultimately cancelled the policy because they couldn't pay the premiums.

Comment: This was the sad, but preordained, result. It took less than two years for a significant part of the Strategy to implode.

October 1992-The NIMCRUT trustee sold the Sawmill Property.

Comment: Seven years after it went up for sale, the Sawmill Property finally sold, thereby clearing the way for NIMCRUT distributions to commence.

January 1993-The Martins receive their first NIMCRUT distribution.

Comment: The Martins receive their first NIMCRUT distribution, only almost 2 ½ years after the NIMCRUT was formed and about two years too late to save the insurance policy. It seems very doubtful that the Martins would have proceeded with the Strategy had they fully appreciated their precarious financial position.

July 19, 1994-Martins file a complaint in the Franklin County OH Court of Common Pleas, alleging claims for fraud, negligent misrepresentation, breach of contract, and breach of fiduciary duty against the Foundation, the Foundation's treasurer, Clark, Wolfe, the insurance company general agent, and the insurance company.

Comment: The Martins' lawyer sued everyone except for Hertenstein.

October 13, 1998-Great West's motions for summary judgment are denied.

Comment: When the insurance company's motions for summary judgment are denied, this virtually guarantees trial, and with that, the prospects for settlement likely significantly increased.

December 1998-Martins settle with the Foundation for $675,000 by purchasing the Martins' unitrust interests, thereby collapsing the NIMCRUT.

Comment: As noted above, the denial of the motion for summary judgment probably caused the Foundation to realistically analyze its potential exposure and settle.

September 21, 1999-Trial commences as to the remaining defendants.

October 19, 1999-Directed verdict in favor of the remaining defendants, and Raymond appeals.

November 16, 1999-Margaret dies.

Comment: Litigation can be very stressful for people who don't experience it often. Who knows whether the stress of the case had anything to do with Margaret's heart attack, but that possibility can't be foreclosed. As an aside, note that the younger and healthier spouse died first. We frequently see second-to-die life insurance used in these types of couples, e.g., where one spouse is rated or even uninsurable alone. If the healthier insured dies first, the less healthy insured will have to keep paying the premiums because the policy won't pay off until the survivor's death, which can be a real financial burden on the less healthy survivor.

October 17, 2000-Ohio Tenth District Court of Appeals reverses and remands for trial.

July 26, 2001-Jury trial results in a mixed verdict. Of the eight separate counts, The eight member jury found in favor of the Martins on just two of the counts: negligent misrepresentation of the nature of a charitable remainder trust. The two verdicts were rendered against Clark and his general agency for a total of $364,000. The jurors found in favor of the defendants on the other six counts, which included all claims against the life insurance company for both fraudulent and negligent misrepresentation. Additionally, the jury found against the Martins on their count that Clark and his general agency fraudulently misrepresented the nature of a charitable remainder trust.

Comment: Tough jury in my opinion. I thought that the size of the award was small in comparison to the value of the Sawmill Property. In my opinion, the fraudulent misrepresentation claims had merit, at least against Clark and his general agency, and I think that the Ohio appellate court agreed with me. However, there was no further appeal.

Hints that the Strategy was ill-conceived from the start:

It should have been easily foreseeable that the Strategy was doomed from the outset. For starters, the $45,000 annual life insurance premium was almost **twice** the Martin's $24,000 annual **pre-tax** income. The Martins, in reliance upon the **repeated representations** that they'd begin receiving distributions from the **beginning**, spent almost all of their savings in year one on the insurance premium and a down payment on Florida property, under the assumption that regular distributions were on the way.

The Sawmill Property had been actively for sale for **five** years prior to being put into the NIMCRUT. Did anyone really believe that simply putting the Sawmill Property into NIMCRUT solution would increase its salability? Clark and Wolfe only presented two possible plans: the Strategy, which financially benefitted them, and an installment sale over 24 years (which they themselves called a "bad plan").

The appellate court found the following problems with the work of Clark and Wolfe:

The appellate court found that Clark and Wolfe only presented one **real** plan, one that benefitted **them** to the tune of a 70% first year premium commission (about $30,000), plus 3-5% of subsequent premium payments, and Fellows referred to them as "**mercenary**" in an internal memorandum to the Foundation treasurer. All NIMCRUT illustrations that they gave the Martins showed **immediate** distributions from the NIMCRUT, and they withheld a memo from Fellows to the Martins that they wouldn't get anything from the NIMCRUT until the Sawmill Property sold. Once Fellows determined that Clark and Wolfe were mercenaries, he should have redoubled his efforts to get an unfiltered message to the Martins about the overarching importance of sale of the Sawmill Property.

Clark arranged for the Martins' NIMCRUT to be drafted by a lawyer who had no relationship with them. The Martins didn't even see the NIMCRUT instrument until the day that they signed it. The Martins apparently got no advice as to the appropriateness *vel non* of the NIMCRUT to their unique situation, which, in my opinion, they desperately needed. In my opinion, the Martins should have reasonably expected that from someone, probably the scrivener of the NIMCRUT instrument. However, the jury seems to have believed that it was more up to the Martins to protect their interests.

Lessons Learned:

In addition to the lessons discussed earlier, i.e., the Foundation being immortalized in the jurisprudence as the lead defendant, there are other lessons that can be gleaned from this case.

Charitable intent anyone? Query whether the Martins really cared about the Foundation or The Ohio State University? Is this one that simply happened to the Foundation, but could have happened to any charity that Clark and Wolfe recommended? That's entirely possible. Donors who seek out maximum returns on split-interest gifts are more likely to catch a bad case of donor's remorse as well as to sue if things don't go according to Hoyle. Donors who have a stronger affinity for the charitable organization are far less likely to litigate if things go south, as they did here.

Mismatches All Around. The Martins really couldn't **afford** the loss of access to the **capital** represented by the Sawmill Property. They really couldn't afford to give it away and not get an immediate return.

This was a player-property mismatch. It really was a cardinal sin to have allowed this to happen, so the NIMCRUT was inappropriate *ab initio* for the Martins. This is something that a lawyer who was truly looking out for their interests would have pointed out to them. This is why it was so unfortunate that the Martins weren't effectively represented by counsel.

The use of the NIMCRUT with the Sawmill Property was ill-advised in my opinion because the Martins needed **immediate** cash flow, and the Sawmill Property already had been for sale for **five years**. **This was a technique-property mismatch.** In my experience, the existence of **any** mismatch between the players, property and technique usually sounds a death knell for the success of the technique. In this case, incredibly, there were two mismatches.[12] Simply put, the Strategy never had a chance. It was dead on arrival.

Query whether anyone considered the possibility of an immediate **charitable gift annuity** with the Martins? Based upon the Martins' ages at the time, had the Foundation agreed to take real estate for a charitable gift annuity (this seems doubtful given the low immediate prospects for sale of the Sawmill Property), they could have received a 6.3% annuity back in 1990, which isn't much lower than the 7% NIMCRUT payout that they **never** received and more than the 5% that they **actually** received, and it would have been **guaranteed**, backed by all of the Foundation's assets. However, it's highly unlikely that this alternative never got discussed. Why?

The Martins didn't really have a true advocate, and that was their principal problem. Hertenstein was hired and likely paid by Clark and Wolfe, who carefully managed the process to their benefit-not that of the Martins. Hertenstein apparently didn't look into the Martins' needs or consider the appropriateness *vel non* of a NIMCRUT for them. He simply drafted a NIMCRUT instrument as requested. Did Hertenstein allow himself to be reduced to nothing more than an agnostic order taker (a NIMCRUT and fries to go, please)? Did Hertenstein effectively abdicate his **counselling** responsibility, **probably even ethically**, to the Martins?[13]

Perhaps I'm hypersensitive to "have form will travel." Having co-authored a will and trust formbook, I've also been hired to draft specimen forms for companies, including charitable remainder trust forms. I've witnessed some bizarre bastardizations of our forms. I would have never taken such an engagement as this one because of the potential for problems just like the Martins encountered. The risk of something significant being missed is too great to draft a document as sophisticated as a NIMCRUT without first talking to the clients to ascertain whether it was even the **right tool** for them. But that didn't happen. In my opinion, the "why" in estate and charitable planning is much more important than the "how."

Conclusion: This matter indeed was an unfortunate affair. The Strategy failed, leading to stressful litigation for the Martins as well as the defendants. Had the Martins received proper advice, I don't think that they would have proceeded with the NIMCRUT when they did.

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1 My purpose here is not to cast aspersions, denigrate or second guess but to educate. The information that I had to work with was taken from public records and is only as accurate as those records. My opinios are just those: opinions.
2 Attributed to Gregg Easterbrook.
3 Robert A. Heinlein.
4 Oliver Wendell Holmes.
5 RIP Paul Harvey.
6 https://www.marketwatch.com/story/81-million-americans-wont-pay-any-federal-income-taxes-this-year-heres-why-2018-04-16
7 742 N.E.2d 1198, 139 Ohio App. 3rd 89 (Ohio App. 2000).
8 And that's saying something because I have been my own boss for over half of my career, and Vern was a better boss for me than yours truly.
9 Hat tip: Vern Snyder, ACFRE.
10 The Martins also sued the Foundation's treasurer, but only in his official capacity. The Foundation defended him. Michael Fellows ("Fellows")-Director of Trusts & Estates for the Foundation, didn't get sued. Willis Wolfe ("Wolfe")-Lawyer-financial planner-Pro Plan man also apparently either didn't get sued either or he got out earlier. Edward C. Hertenstein, Esq. ("Hertenstein")-Lawyer who drafted the NIMCRUT at Clark's behest, also didn't get sued.
11 IRC Sec. 170(f)(11).
12 For more information, see Hood, "Hermeneutic for Evaluation, Selection and Design of Estate Planning Tools and Techniques," *BNA Tax Management Estates, Gifts and Trusts Journal*, May 12, 2005, at pp. 155-175.
13 Rule 1.2, Scope of Representation and Allocation of Authority Between Lawyer and Client, Model Rules of Professional Conduct.