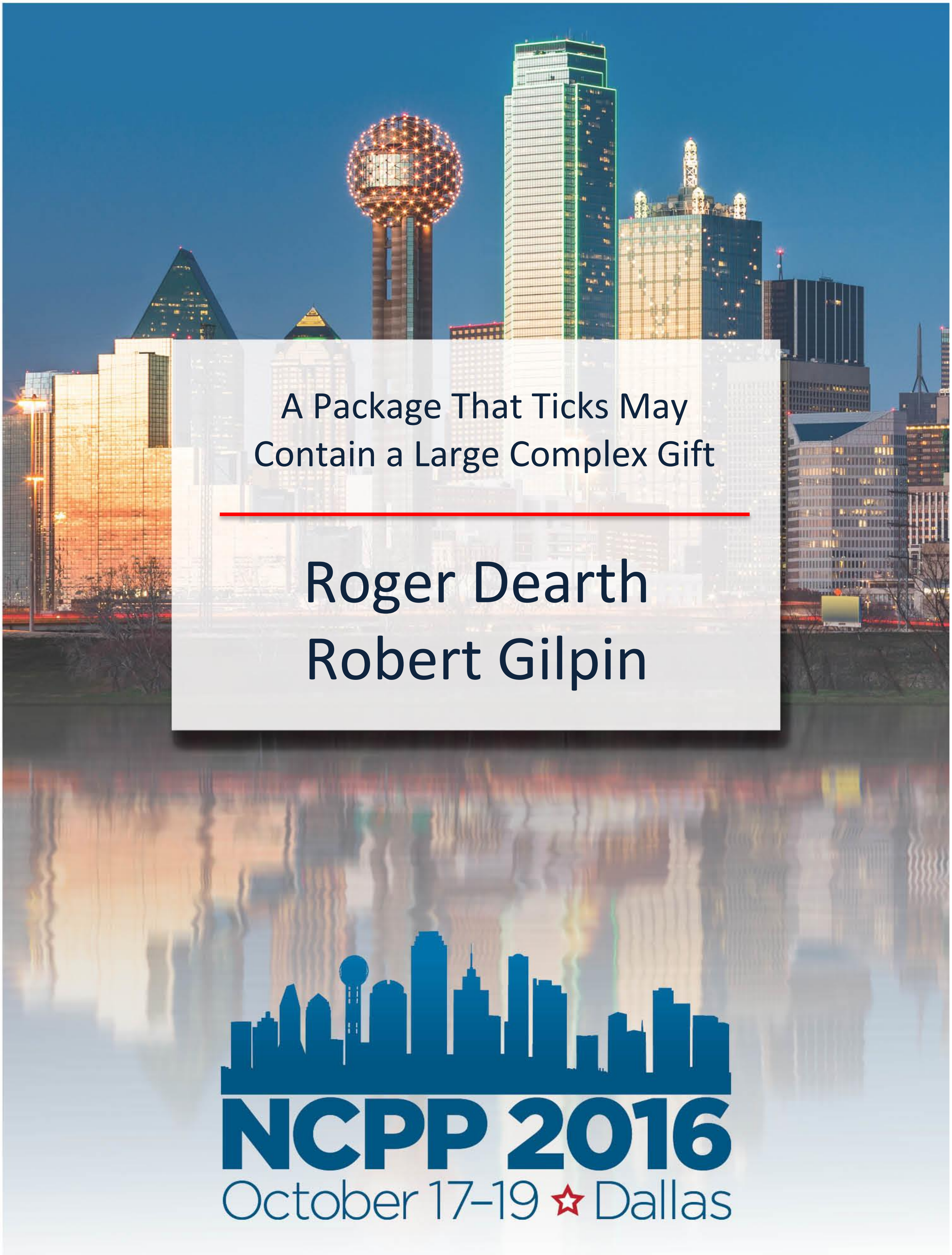

A Package That Ticks May Contain a Large Complex Gift

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I. In the Beginning

A. Over their lifetime, the Smith family built a valuable telecommunications business in the rural South overcoming many challenges — substantial disruptions occurring in the underlying industry, problems with children working in the business, and the premature death of the active founder and family patriarch — that ultimately resulted in the controlling shareholder deciding the next generation would be unable or unwilling to manage the family business to preserve the founders' legacy and the best interests of long-term employees who were like an extended family.

B. Eventually the founders decided to begin receiving health care at Mayo Clinic in Rochester, Minnesota. Over time they were introduced to the work and mission of Mayo Clinic and the opportunity to donate to this work. Their initial small gift to Mayo Clinic came in 1986. The seeds were sown. Mayo Clinic is a global center of health and healing that serves 1.3 million patients in all 50 states and 140 countries. Mayo Clinic was recently named the No. 1 hospital in the *U.S. News & World Report* annual survey. Patients know this renowned medical institution as a place of compassionate care coupled with medical innovation and ingenuity.

C. Mayo Clinic and two other charities were considered as potential beneficiaries for some portion of the couple's estate plan as early as the 1980s. A few years later the patriarch's health began rapidly declining, and the business and family assets were left to trusts with no gift or estate taxes being owed. This resulted in the all too typical controversy between the adult children working in the business and the surviving widow who had been primarily focused on caring for her sick husband. The family disputes resulted in numerous lawsuits and a state of perpetual family acrimony. As the controlling shareholder, the matriarch was forced to step back into the business, terminating the employment of both children, buying out their small ownership stake, and bailing out one son from numerous bad business deals. These actions ultimately saved the business and secured its long term continuity.

D. The litigious child sued his mother and the Company at least three times over her lifetime, and the dutiful spendthrift child remained on his mother's payroll receiving a monthly allowance plus access to vacation properties and other luxury items. Feeling her obligation to her children was fulfilled in her lifetime, the matriarch therefore decided to leave the proceeds from the sale of the business at her death to charity. She stabilized the business, maintained an iron hand over corporate expenditures, minimized personal distributions, listened to seasoned managers, and invested in new technologies. The Company was early to embrace and deploy new technology, and the investment paid off. This laid the ground work for the Company to survive in a rapidly changing, highly-regulated business.

E. In an effort to give the dutiful child one last chance at success, the widow gave the child $6.0 million in exchange for an Inheritance Rights Agreement. Basically, the document said, "Do not call me unless I call you; do not come to me with your financial needs; and do not dare interrupt my testamentary intentions. If you do any of the foregoing, you owe the money back, and I have the right to seek an injunction to enforce our agreement." This agreement was similar to a prenuptial agreement. A redacted copy of this agreement is available in the online bibliography.

II. The Charities

A. The matriarch continued to receive care at Mayo Clinic. Her bond with her physician was deep and personal, but her relationship with the Department of Development was distant, as she expressed no interest in stewardship and "fired" her assigned development officer. The relationship was solely between a caring doctor and concerned patient. The widow was trained as a nurse and knew how to talk to her doctor even though he was 1,000 miles away. The doctor made himself available at all times, and the patient never abused this privilege.

B. The widow had established approximately $750,000 worth of deferred annuity accounts with other charities, and her estate intentions originally included bequeathing them further significant distributions.

III. The Call

A. After about two decades the matriarch's health suddenly began to decline but even the week leading up to her death she signed the payroll checks for the Company employees. During that same week the dutiful son sent his wife to convince his mother to re-write her estate plan so that he inherited the business assets instead of Mayo Clinic. But, thanks to the inheritance rights agreement, his mother was able to get a temporary restraining order against him, thus thwarting the attempt.

B. At her funeral, the preacher started with the word "control." It was clear she wanted everything buttoned up, and it was. Her wishes were clear in her estate planning documents. As she had anticipated, only one son showed for her funeral service, which was attended by hundreds. Of course, he still dreamed of somehow buying the business.

C. Her longtime legal counsel called Mayo Clinic to tell them of the bequest, which was initially estimated to be in excess of $15 million. The Department of Development was surprised by the magnitude. Their records indicated a gift annuity and a few contact reports, but they had no other expectations, since for more than a decade they had adhered to her wishes to only have contact with her Mayo Clinic physician In fact, no current employees in Mayo Clinic's Department of Development in Minnesota really knew her.

D. The assets of the Estate were primarily real estate, stock in the Company, and cash.

1. Mrs. Smith left her real estate assets to two people: Mr. Jones, a loyal, long-term employee at the Company, and the dutiful son. Mr. Jones received a large acreage of rural farm timberland used for hunting. The dutiful son received all other real estate assets, including two resort homes, her personal residence, and the commercial office building leased to the Company.

2. Mrs. Smith bequeathed 100 percent of her business assets to Mayo Clinic and designated the sale proceeds and profits for medical disease research. Upon learning of her death, the other charities that had not adhered to her wishes and continued to solicit her sadly learned that they had not been included in her final estate plans.

IV. The Visit

A. While many charities would be instructed by their finance department to ask the Trust to liquidate the asset and send the proceeds, Mayo Clinic immediately realized the potential value of the gift but also the risks of being an absentee owner not involved in the sale process. These risks included not receiving optimal value from the sale plus the potential reputational risks of an unsuitable buyer, disaffected employees, or having others involved in the transaction with ulterior motives. In short, an institution of Mayo Clinic's size and stature could not afford to be uninvolved. Therefore, Mayo Clinic sent a senior financial director and an investment banking team to "size up" the management, the value of the Company, and the Estate team. At the initial visit, the doors to the Company were opened by the Executor and Trustee, who had served as long-time counsel to the widow and the Company, the senior managers of the Company, and the long standing external accountant. This was essentially the team that had been supervising the widow's personal well-being and the management of the Company for two decades due to the estrangement of the children. The four senior managers had a total of more than 120 years of employment with the Company. A complete facility tour and open financial records were available to the initial Mayo Clinic team. The client had left clear instructions: "Sell the Company and give the proceeds to the Mayo Clinic."

B. The initial meeting laid the groundwork for cooperation between the Estate team and the Mayo Clinic team, which continues to this day. Both teams shared a common goal to manage the business and a sale process to maximize the highest return to the charity while honoring the work of the founder, the Company, and its employees. While it was clear to the Estate team that this initial visit was an extensive checkup, the Mayo Clinic financial director, having experience with this type of complex asset, immediately saw the value in the management team, the cooperative spirit, and the ability to maximize the net proceeds. The goals and objectives of all were aligned even though the investment bankers were pushing for a quick fire sale.

V. The Decision

A. Mayo Clinic was presented with an opportunity. Although, the business was highly regulated, it was a stable cash producer generating several million dollars a year in net cash flow. The business had no debt. A key decision for Mayo Clinic was whether to continue the capital investment plan or to cut capital and just increase cash flow. Management, the Estate, and Mayo Clinic came to a consensus that continuation of the capital expenditure plan protected the value of the Company and reduced the risks of competition. In addition, Mayo Clinic has substantial alternative investments and called upon industry experts to consider deploying the Company as a long-term asset. Even though the nature of the business and the risks in the industry led Mayo Clinic to continue on a path of selling the business, their willingness and expertise to even consider a long term investment strategy, coupled with their ability to think beyond the immediate cash needs and a cooperative attitude, put the Charity on the same path as the Estate to pursue a sale of a going concern to maximize value.

B. Once the decision was made to pursue a sale of a going concern, corollary decisions involved incentivizing managers for midterm employment while the business was being marketed and continuing the capital investment plan based on approval and consent of Mayo Clinic. Approval and consent was also obtained to terminate one excess employee who primarily was kept on the payroll by the widow as a concession to the dutiful child. In all decisions, both parties focused solely on maximizing value for the charity rather than asserting their own legal standing, refighting old battles, or focusing on short-term cost savings.

VI. The Plan is Set

A. The plan was set. Management continued to operate the Company with regular oversight from the Trustee, monthly reporting to Mayo Clinic, and quarterly sit-down meetings to discuss operations and the sale process details. A number of meetings were held with all employees to make sure they understood the objective was to continue operating the business.

B. Mayo Clinic built trust with management, not only through its words and representatives, but also through its actions. Mayo Clinic agreed to an incentive program that reinstated the profit sharing plan for all employees. Key managers were also signed to retention bonuses to be paid upon the successful sale.

C. Initial valuations were obtained to assist Mayo Clinic in reporting to its executive team to set realistic expectations and assure accurate recording on Mayo Clinic's financial statements. Very clear and consistent lines of communication were established. Trust was built based on a concept of investing in the relationships.

D. A sale process was established, and potential brokers were interviewed by both Mayo Clinic and the Trustee. Based on regulatory complexity and the close-knit relationships within the industry, a mutual decision was made to hire a local firm with deep experience and relationships in the industry to market the business rather than one of the national firms proposing a rather rapid nationwide auction process. The chosen firm developed a process which involved soliciting indications of interest resulting in offer letters from eight potential acquirers. The spread between the lowest and the highest offer was the amount of the lowest offer. The objective was to identify interests and to push the three lead horses into a horse race. A winner was selected from this horse race process, and the Estate pushed toward a closing. The winner was not the highest bidder, but the bidder who was considered the most likely to close and whose values appeared to match with the Company, its employees, and Mayo Clinic.

VII. The Crash

A. The team selected a young energetic entrepreneur as the buyer. The complex closing process moved smoothly with excellent communications between all parties. Then, on the afternoon when the buyer received his final financing commitment, he tragically died in a plane crash along with a flight instructor while being recertified on the corporate jet.

B. There was no established playbook for managing such a tragedy. Both Mayo Clinic and the Trustee wanted to allow the buyer's widow time to grieve and assume the mantle of the company she had just inherited. Even though the sale process was suspended, Mayo Clinic remained patient knowing the retention contracts were in place and the continued excellent cash flows would further demonstrate the Company's underlying value. Unfortunately, the manager hired by the potential buyer's widow lacked entrepreneurial zeal and presumed that, since the seller was a charity, it lacked sophistication, badly needed cash, and was ripe for a fire sale and nitpicking.

C. After several months of trying to close, the original buying firm had to be jettisoned and the sale process repeated. This was a time of great risk since, in this industry, a company brought back to market after failing to close is generally considered damaged goods with the next round of offers being lower than the first. Fortunately, since the Charity and Trustee had agreed to hire the local specialist over the national firm, the broker was able to personally reconnect with the former bidders to explain the tragic reasons behind the Company's return to market and skillfully resell the underlying value. The broker's skill coupled with continued outstanding business results led to the previous lowest bidder essentially doubling their original bid to become the winning bidder. They were an adjoining service provider with the opportunity for tremendous synergy, and this bidder really needed the operational expertise of the employees. Mayo Clinic had established a strong preference to avoid layoffs within the very small community the Company calls home, so this buyer was a perfect fit.

VIII. Controversy

A. The estate plan excluded the litigious child and his family. The plan gave certain real estate assets and personal property to the dutiful child.

B. The family of the litigious child brought legal action attempting to contest the Will and Trust. The Estate had express instructions from Ms. Smith not to "pay a dime" to any excluded family because they had received enough. The Estate had no choice but to take a firm, hard line.

C. Mayo Clinic on the other hand wanted to resolve any controversy and worked to successfully settle these claims. Since Mayo Clinic was the Trust beneficiary, it had the legal right to make the settlement. However, an extra step was devised in the form of an interim distribution to Mayo Clinic which allowed the Trustee to honor his word that the Estate would not pay any settlement. The bonds of trust already forged between Trustee and Mayo Clinic allowed them to understand and respect their differing viewpoints to prevent an expensive legal battle that would also taint the value of the Company by giving the impression of a desperate seller. Releases were obtained thereby eliminating any claims or hindrances to the sale of the business.

IX. Operations

A. The Company continued to operate profitably with the employees confident in their future and not a single employee left despite Mayo Clinic's temporary ownership lasting over three years.

B. The Estate, with the consent and review of Mayo Clinic, elected to treat the Trust as an estate for purposes of income taxes. This allowed the Estate to treat the taxable income from the S corporation as passing directly through to the charitable beneficiary, avoiding any negative income tax consequences (i.e., charitable deduction limitations or unrelated trade or business issues).

C. A change in the regulatory environment allowed the Company, as a rural provider of certain services, to be reimbursed for capital expenditures made in the preceding 24 months. The impact of this change was to increase the cash flow projections and, accordingly, the value of the Company. Mayo Clinic was rewarded for continuing to make capital expenditures.

X. Structure of the Transaction

A. The Company was a qualified Subchapter S corporation. This means that all of the income and loss is deemed distributed to its shareholder.

B. As noted above, the election was made to treat the Trust as an estate and the income flowed from the Company to its shareholder, the Trust, which was taxed as an estate and in turn distributed the income out to the charitable beneficiary without negative income tax consequences.

C. Typically, a buyer desires to acquire assets in order to minimize liabilities and maximize tax basis in the purchased assets, allowing a subsequent depreciation tax deduction of the acquired assets. Typically, the Seller wants to sell stock because the seller receives capital gain income tax treatment paying tax at the lower rates.

D. In this structure, the seller had little exposure to any taxable income regardless of rate because it was allocable to a tax-exempt entity and the unrelated trade or business rules did not apply because of the estate election described above. Accordingly, to maximize the purchase price, the seller accommodated the buyer and permitted the buyer to make an election to treat the sale of stock for tax purposes as a sale of assets. This is called an Internal Revenue Code Section 338(h)(10) election.

E. As is typical, the seller insisted on an escrow to guard against potential liabilities. The escrow was for two years but no claims have been filed.

XI. Epilogue

A. Thanks to the collaboration between the Estate team and Mayo Clinic, the steps taken during the sale of the Company resulted in increased job security for the Company's employees. That, along with Mayo Clinic's close relationship with the employees, enhanced Mayo Clinic's already extraordinary reputation in the community. They were able to do all of this in the name of fulfilling Mrs. Smith's wishes for the bequest, which was to fund medical research.

B. Mayo Clinic has received more than $20 million to date with a large final distribution still due at the end of the escrow period. Even though there were no family members to steward, Mayo Clinic honored the gift by naming and endowing a major research center with an outstanding international reputation in honor of the benefactors along with an endowed professorship. To honor the dedication of the employees for more than three years of service to Mayo Clinic, an additional research endowment was named in their honor.

C. The employees of the Company continue to work and grow the Company, and the new owners have honored their commitment to retain all employees. The key synergies expected with the purchase have been realized.

D. The senior financial director for Mayo Clinic and the Trustee continue to work together even today as the final escrow from the Company sale and Estate wrap-up near completion. The partnership has expanded awareness of and demand for Mayo Clinic care in the region along with identifying potential future Mayo Clinic benefactors.