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March 31, 2005

Hon. Charles E. Grassley, Chairman
Committee on Finance
United States Senate
Washington, D.C. 20510-6200

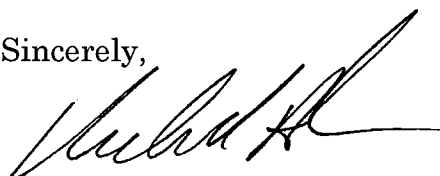
Re: *Charities and Charitable Giving: Proposals for Reform*

Dear Senator Grassley:

Thank you for your letter of March 23, 2005 and your kind invitation to present testimony on the referenced issue at the Committee's hearing on April 5, 2005 which I gratefully accept. Pursuant to the instructions in your letter, also enclosed are our final testimony and a short biography of myself and my law partner, Mr. Woodruff. Although Mr. Woodruff and I jointly prepared the written testimony, only I will be providing oral testimony and answering the Committee's questions.

Please also accept my sincere thanks for the courteous and invaluable assistance of the Committee's staff. Without exception they have been helpful, informative and professional. I look forward to appearing before the Committee.

Sincerely,



Richard A. Johnson

RAJ/

March 31, 2005

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bcc: Ms. Tommye Maddox Working
Ralph W. Davis, Esq.
Joseph A. Woodruff, Esq.
Robert E. Boston, Esq.

Joseph A. Woodruff is a member of Waller Lansden Dortch & Davis, PLLC. He manages the Financial Services Litigation group within the law firm's Trial and Appellate Practice. His professional practice is concentrated in the area of civil litigation, and he has extensive experience representing institutional and individual fiduciaries.

Mr. Woodruff earned his BA degree from the University of Alabama in 1974 and his JD degree from the University of Alabama School of Law in 1981. He served on active duty in the United States Army from 1974 until 1987, with his last six years of commissioned service in the Judge Advocate General's Corps. He is licensed to practice law in the States of Alabama and Tennessee, and is a member of the bar of the United States Supreme Court. He is a member of the Alabama State Bar, the Tennessee Bar Association, the Federalist Society for Law and Public Policy Studies, and is a fellow of the Nashville Bar Foundation. Mr. Woodruff has published and lectured on legal matters and is named in both the 2004/2005 and 2005/2006 editions of *The Best Lawyers in America* for civil litigation.

He is lead counsel for the plaintiffs in the case of *State of Tennessee, ex rel. Working, et al. v. Maddox Foundation, et al.*

Richard Johnson is a member of Waller Lansden Dortch & Davis, PLLC and manages the Tax Practice Group. He has extensive experience in the areas of federal and state taxation including tax exempt entities.

Mr. Johnson earned his Bachelor of Accounting degree, cum laude, from the University of Mississippi in 1983. In 1986, he received his Juris Doctor degree, with Honors, from the University of Tennessee and in 1987, received his Master of Laws in Taxation from the University of Florida.

Mr. Johnson is a member of the Nashville, Florida, Tennessee and American Bar Associations and is chairman of the Tax Section of the Tennessee Bar Association. He is chairman of the Estate Planning Section for the Nashville Bar Association. He is also a fellow of the American College of Trust and Estate Counsel and of the Nashville Bar Foundation; and commentator and lecturer at various tax seminars. Mr. Johnson is named in *The Best Lawyers in America* 2005/2006 edition for tax law and trusts and estates.

**WRITTEN STATEMENT OF
JOSEPH A. WOODRUFF AND RICHARD A. JOHNSON
ATTORNEYS-AT-LAW, WALLER LANSDEN DORTCH & DAVIS, PLLC
NASHVILLE, TENNESSEE**

**BEFORE THE COMMITTEE ON FINANCE
UNITED STATES SENATE
HEARING ON TAX EXEMPT ORGANIZATION REFORMS
APRIL 5, 2005**

Thank you, Mr. Chairman, Senator Baucus and distinguished members of this Committee, for the opportunity to comment on the legislative reforms for tax exempt organizations contained in this Committee's staff discussion draft. Our views on this contemplated legislation are influenced by the facts and circumstances of STATE OF TENNESSEE, by and through VICTOR S. (TORRY) JOHNSON, III, District Attorney General, ex. rel. TOMMYE MADDOX WORKING, et al. v. ROBIN G. COSTA, et al. which have been reported in the February 16, 2005 edition of the New York Times.

This written submission is intended to provide this Committee with an understanding of how we believe things went wrong with the Maddox Foundation and to assess how the reforms in oversight and governance of tax-exempt entities being considered by this Committee might have prevented the abuses which have been alleged and which the State of Tennessee now seeks to rectify.¹

¹ The State of Tennessee lawsuit against the Foundation and its controlling director was filed on August 31, 2004 and is still pending. Although the Court has made certain interlocutory rulings – such as appointing a special fiduciary to conduct an accounting – no trial has been held. The facts set out in this testimony are contained in affidavits, depositions and documents on file in the Court record, as well as public disclosures made by the Maddox Foundation and other tax-exempt entities pursuant to the Internal Revenue Code. Footnotes herein refer the reader to such source documents, many of which are contained in a supplement to the Committee record submitted by the authors. This testimony also contains the opinions of the authors which are provided for the purpose of informing the Committee of the application of existing and contemplated law to the facts.

INTRODUCTION

In October 1997, Dan Maddox, a wealthy Nashville, Tennessee businessman, was putting the finishing touches on estate plans for himself and his wife, Margaret. He was being advised and assisted in this estate planning by Professor Jeffrey Schoenblum of Vanderbilt University Law School. Professor Schoenblum asked Mr. Maddox to prepare a written narrative explaining his reasons for the decisions he had made in his estate plan. Mr. Maddox did so in the form of a letter to Professor Schoenblum. In that letter, Mr. Maddox wrote about the charitable works he and Margaret had done through the years, and concluded:

The charitable contributions have filled a highly productive and personally rewarding need in this wonderful Nashville community that has been so good to Margaret and to me. I am delighted to show my appreciation by leaving substantial funds **to help in Nashville's problems** and to make a big positive difference in a lot of youngsters lives. (Emphasis added.)

In his Last Will and Testament, Mr. Maddox left the residuary of his substantial estate to his wife. In her Will, Mrs. Maddox left the residuary to a charitable trust, the Maddox Foundation Trust, created years earlier. The Maddox Foundation Trust, in accordance with the language of the Trust Agreement, required a minimum of three trustees,² and had operated for many years as a tax-exempt private foundation. Through this trust, Mr. and Mrs. Maddox had established a laudatory track-record of support for charities in Middle Tennessee, predominantly the YMCA and Belmont University.

What neither Dan nor Margaret Maddox were able to foresee were their simultaneous deaths in a boating accident. Likewise, they could not have foreseen that within two years of their untimely deaths, the substantial wealth Mr. Maddox had built during his life would be hijacked from Tennessee to Mississippi, placed under the effective control of a single person,

² See Maddox Foundation Trust Agreement ¶ 9, Appendix at Tab No. 1.

Ms. Robin G. Costa, used to purchase two ailing professional sports teams, squandered on lavish trips and high-living, and diminished by imprudent investments and excessive personal compensation paid to Ms. Costa all as alleged in a pending lawsuit.

On August 31, 2004, the State of Tennessee, through the office of the Hon. Victor S. (“Torry”) Johnson, District Attorney General of the 20th Judicial District, filed a civil action in the Probate Court of Davidson County, under the authority of the Tennessee *quo warranto* statute.³ That *quo warranto* action was made possible by the efforts of Tommye Maddox Working, Dan and Margaret Maddox’s step-granddaughter. On November 22, 2004, following an extensive hearing, Judge Randy Kennedy entered a temporary injunction against the Maddox Foundation Corporation and Ms. Costa, and appointed a well-respected accounting firm, Frasier Dean & Howard, as special fiduciaries to conduct an accounting of the Maddox Foundation. This accounting is only a preliminary stage of a much longer process that, the State of Tennessee hopes, may lead to restoring transparency and accountability to the affairs of the Maddox Foundation and preserving Dan and Margaret Maddox’s legacy for the people and charities of Middle Tennessee.

BACKGROUND FACTS

A. Dan Maddox

Dan Maddox, the youngest of five children, was born to a family of modest means in Easonville, Alabama, in 1909. He left college when his father died suddenly in 1929 and was required to liquidate his father’s business to repay bank loans. He then took a job with CIT Corporation in New York, transferring to its Nashville office which, at the time, was the least

³ Tenn. Code Ann. § 29-35-101, et seq.; *see also State of Tennessee, et al. v. Costa, et al.*, Seventh Circuit Court for Davidson County, Tennessee (Probate Division), Case No. 04P-1430.

profitable office in the company. By 1933, Dan Maddox had transformed the Nashville office to the most profitable in the company and he was promoted to Regional Manager.

In the mid-1940's Mr. Maddox founded an investment group focusing on consumer finance. This entity became known as Associates Capital Corp. and was later acquired by Gulf & Western Industries. Through his hard work, Dan Maddox established himself in the worlds of finance, oil and gas exploration and real estate development. His business success was matched by his and Margaret Maddox's philanthropic generosity. At the time of their deaths, the Maddox name was associated with a number of substantial charitable projects in Middle Tennessee, including the Margaret Maddox Family YMCA, the Maddox Hearing Aid Research Center at the Bill Wilkerson Center of Vanderbilt University, and Maddox Hall dormitory at Belmont University. They also supported numerous scholarship programs and other direct grant projects which over the years have contributed millions of dollars to educational and charitable endeavors.

B. The Maddoxes' Estate Plans

1. The Trust Agreement

The Maddox Foundation Trust is a Tennessee charitable foundation that was created pursuant to a Trust Agreement executed on October 10, 1968 (the "Trust Agreement").⁴ Dan and Margaret Maddox donated the corpus of the Trust, which was established

exclusively for charitable, religious, scientific, literary, and/or educational, purposes, either directly, or by contributions to organizations duly authorized to carry on charitable, religious, scientific, literary, or educational, activities.⁵

⁴ See Maddox Foundation Trust Agreement, Appendix at Tab No. 1

⁵ *Id.* ¶ 2.

The Trust Agreement specifies that “no part of the assets of [the] Trust, either principal or interest, shall inure to the benefit of any private individual,” and directs the trustees “to distribute from time to time for educational, religious, charitable, and scientific uses and purposes . . . such amounts of income or principal of this Trust fund as, in their discretion, they may appoint, order, or direct.”⁶ In addition, the Trust Agreement provides that “the number of TRUSTEES shall never be less than three (3).”⁷ The Trust Agreement could be amended only “by the unanimous agreement of DONOR and the TRUSTEES, provided that there be not less than three (3) acting TRUSTEES”⁸

From the time the Trust was created up to the time of their deaths, Dan and Margaret Maddox executed ten additional written instruments related to the Trust (some being designated as Amendments and others as Actions on Written Consent of Trustees). The last of these, being an Action on Written Consent of Trustees dated May 9, 1996, provides:

Following the death of Donor, Donor’s wife, Margaret H. Maddox, shall be appointed Chairman of the Trustees, to serve for a one (1) year term and successive one (1) year terms until replaced by a successor. If Donor’s wife, Margaret H. Maddox, is for any reason unable or unwilling to serve as Chairman, or having qualified shall resign or die, then Robin G. Costa and Tommye B. Maddox will serve as the Co-Chairmen of the Trustees for a term of one (1) year and successive one (1) year terms until their successor is designated by the Trustees. Following the death of Donor and the death of Donor’s wife, the Board of Trustees will be comprised of Robin G. Costa and Tommye B. Maddox; they will have the right to jointly elect one or more persons to serve with them on the Board of Trustees.⁹

In addition, the Trust Agreement authorizes, but does not require, the Trustees to create a non-profit corporation to take the place of the Trustees and carry on the charitable purposes of

⁶ *Id.* ¶ 6.

⁷ *Id.* ¶ 9.

⁸ *Id.* ¶ 14.

⁹ *See* Action on Written Consent of Trustees dated May 9, 1996, Appendix at Tab No. 2.

the Maddox Foundation Trust. Specifically, the Trust Agreement provides that the Trustees may “form and organize a corporation for the uses and purposes provided by [the Trust Agreement], such corporation to be organized under the laws of Tennessee, and such corporation, when organized, shall have the power to administer and control the affairs and properties of [the] Trust, and to carry out the uses, objects and purposes of [the] Trust.”¹⁰

An Action on Written Consent of Trustees executed on September 5, 1986, allowed the corporation “to be organized under the laws of the State of Tennessee, and/or such other State, as deemed appropriate by the Trustees”¹¹ “Such corporation, if organized, shall be named ‘Maddox Foundation.’”¹² The corporation, if formed, is to *take the place of the trustees of the Maddox Foundation Trust* and is to have the same powers and authority as were vested in the trustees of the Maddox Foundation Trust.¹³

2. The DWM Trust and the MHM Trust

On January 10, 1981, Dan Maddox, as settlor, created a revocable trust, which was amended, by a Notice and Full Text of Amendment and Restatement of the Trust Agreement dated November 19, 1997 (the “DWM Trust”). One of the co-trustees of the DWM Trust is Ms. Costa.¹⁴ On May 10, 1981, Margaret Maddox, as settlor, created a revocable trust, which was amended by a Notice and Full Text of Amendment, and Restatement of the Trust Agreement

¹⁰ See Maddox Foundation Trust Agreement ¶ 12, Appendix at Tab No. 1.

¹¹ See Action on Written Consent of Trustees dated September 5, 1986, ¶5, Appendix at Tab No. 3.

¹² See Maddox Foundation Trust Agreement ¶ 12, Appendix at Tab No. 1.

¹³ *Id.*

¹⁴ See Notice and Full Text of Amendment and Restatement of the Trust Agreement dated November 19, 1997, Appendix at Tab No. 4.

dated December 17, 1997 (the “MHM Trust”). One of the co-trustees of the MHM Trust is Ms. Costa.¹⁵

Under the terms of both the DWM Trust and the MHM Trust (collectively, the “Maddox Revocable Trusts”), apart from certain, relatively small distributions to family members upon the death of the Maddoxes, all of the remaining assets in the trusts were to be distributed to the Maddox Foundation Trust. The assets of the DWM Trust and the MHM Trust are to be held for the benefit of the Maddox Foundation Trust.

3. The Maddoxes’ Estates

On January 14, 1998, Dan and Margaret Maddox were killed in a boating accident while vacationing in Louisiana. It is estimated that the Maddoxes had in excess of \$100 million in assets at the time of their deaths.

Shortly after the deaths of the Maddoxes, the separate estates of Dan and Margaret Maddox (the “DWM Estate” and “MHM Estate,” respectively), were opened in the Seventh Circuit Court for Davidson County, Tennessee, Probate Division. In accordance with their Wills, Ms. Costa was named a Co-executor of the Maddoxes’ estates. Ms. Costa, in her capacity as a Co-executor of the DWM Estate and the MHM Estate, has paid herself a “co-executor fee” of \$525,000 from the DWM Estate together with a “co-executor fee” of \$875,000 from the MHM Estate. Contrary to the rules and practice in the Tennessee Probate Court, Ms. Costa did not obtain judicial review and approval in advance of these payments.¹⁶

¹⁵ See Notice and Full Text of Amendment and Restatement of the Trust Agreement dated December 17, 1997, Appendix at Tab No. 5.

¹⁶ Although the Court “conditionally” approved these fees on August 13, 2004, final review and approval has been withheld by the Probate Court pending further developments in the present litigation.

The Wills left all estate assets to the DWM Trust and the MHM Trust from which the assets are to pour over to the Maddox Foundation Trust. Ms. Costa, in her capacity as Co-trustee of both the MHM Trust and DWM Trust, paid herself \$250,000 in compensation out of the trust assets.¹⁷ Ms. Costa gave notice of her requests for fees only to herself and the co-executor. No notice of this request for fees was given to the representatives of the charitable beneficiaries.

C. Robin Costa Obtains Control of the Maddox Foundation

The untimely deaths of Dan and Margaret Maddox left only two trustees, Ms. Costa and Ms. Working, in control of the foundation. Although the Maddox Foundation Trust Agreement requires three trustees to oversee the affairs of the foundation, Ms. Costa persuaded Ms. Working that they, as two trustees, could lawfully operate the foundation.

1. The move to Mississippi

At Ms. Costa's insistence, Ms. Working agreed to move the Maddox Foundation Trust to Hernando, Mississippi, in 1999 in an effort to transfer the situs of the Trust to Mississippi. Ms. Costa told Ms. Working that the move was necessary to avoid Ms. Costa's avowed concerns that Maddox family members might engage the Trust in litigation, and because, according to Ms. Costa, Mississippi requires only one trustee instead of the three trustees that would be required in Tennessee. Ms. Working trusted Ms. Costa to make the right decision. Ms. Costa had been her supervisor before the Maddoxes' deaths, and Professor Schoenblum had told Ms. Working that Ms. Costa was to be her boss.¹⁸

¹⁷ See Defendants' Responses to Plaintiffs' First Set of Interrogatories ("Defendants' Responses") No. 4, Appendix at Tab. No. 6.

¹⁸ See Deposition of Tommye Working ("Working Depo."), November 3, 2004 at 101-102, Appendix at Tab No. 7.

On June 14, 1999, Ms. Costa and Ms. Working, as Trustees to the Maddox Foundation Trust, executed an Action on Written Consent of the Trustees of the Maddox Foundation that purported to transfer situs of the Trust for administration and for all other purposes from Tennessee to Mississippi.¹⁹ As alleged, this purported transfer of situs from Tennessee to Mississippi was ineffective, however, because neither Ms. Costa nor Ms. Working applied to the appropriate Tennessee Court for approval of a change of situs, as is required by Tennessee law.²⁰ Had Ms. Costa complied with the change of situs statute, the District Attorney General, as the statutory representative of the charitable beneficiaries, would have been given notice of the proposed relocation and could have acted to stop it. Moreover, Ms. Costa would have been required to file with the Court an accounting of her tenure as trustee.

The lawsuit states that the attempted transfer of situs from Tennessee to Mississippi was legally ineffective because at the time of the purported transfer only two trustees were serving notwithstanding the fact that the Trust Agreement as amended required a minimum of three trustees. Ms. Costa knew this to be the case because, prior to the execution of the June 14, 1999 document purporting to change the Trust situs, Ms. Costa and Ms. Working approached Wallace Rasmussen, the retired Chairman of Beatrice Foods and long-time friend of Dan Maddox, and asked him to serve as the third trustee.

Wallace Rasmussen met Dan and Margaret Maddox in 1974. In addition to being personal friends with each other over the years, he and Dan Maddox also served together on the Boards of Directors of Commerce Union Bank and of Shoney's Restaurants for approximately

¹⁹ See Action on Written Consent of the Trustees of the Maddox Foundation dated June 14, 1999, Appendix at Tab No. 8.

²⁰ See Tenn. Code Ann. § 35-1-122. Note: §122 was repealed by the UTC and replaced by Tenn. Code Ann. § 35-15-101 *et seq.*

fifteen years. During that time Mr. Rasmussen also was Chairman of Commerce Union Bank's trust and audit committees. Shortly before Dan Maddox died, he confided in Mr. Rasmussen that he intended to remove Ms. Costa as administrator of his estate and to replace her with Ms. Working.²¹

After Dan and Margaret's unexpected deaths, Ms. Costa called Mr. Rasmussen to see if he could meet her and Ms. Working for lunch, which was not unusual since he normally took them to lunch several times a month to review their problems of running an office for Dan Maddox. At the luncheon Ms. Costa asked Mr. Rasmussen if he would be the third trustee of the Maddox Foundation Trust. Mr. Rasmussen agreed, and said that he would prepare some guidelines similar to those that a bank trust committee would need to use in order to comply with applicable regulations. Ms. Costa asked Mr. Rasmussen to send her the guidelines as soon as possible. Shortly thereafter, Mr. Rasmussen sent a detailed compliance checklist to Ms. Costa, which was based on his years of experience as Chairman of Commerce Union Bank's trust and audit committees. The next thing he heard from Ms. Costa was that she was moving the Maddox Foundation Trust to Mississippi. When he asked why, Ms. Costa responded that it was easier to operate a foundation in Mississippi as it only required two trustees instead of the three required under Tennessee law.²²

2. *Robin Costa is given broad power over the Maddox Foundation Corporation*

²¹ See Affidavit of Wallace N. Rasmussen ("Rasmussen Aff.") ¶ 4, September 16, 2004, Appendix at Tab No. 9; see also Deposition of Wallace Rasmussen ("Rasmussen Depo."), January 11, 2005, at 29-30, Appendix at Tab No. 10. Mr. Rasmussen concurred in Mr. Maddox's assessment. *Id.*

²² See Rasmussen Aff. ¶ 7, Appendix at Tab No. 9. Notwithstanding Ms. Costa's statement to Mr. Rasmussen, the Mississippi not for profit corporation act allows for a single director. See Miss. Code Ann. § 79-11-231.

On September 13, 1999, the Maddox Foundation Corporation was incorporated as a Mississippi nonprofit corporation. Its only incorporators were Ms. Costa and Ms. Working, “as Trustee[s] of Maddox Foundation Trust.”²³ Pursuant to its articles of incorporation,

the Corporation shall only make contributions to organizations operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, the fostering of national or international amateur sports competition, or for the prevention of cruelty to children or animals.²⁴

The corporate articles specified that “[u]nder no circumstances may any assets or income of the Corporation ever be used for the benefit of any individual or entity, other than in non-excessive payment of services rendered”²⁵

Subject to these limits, the articles of incorporation provided Ms. Costa with extraordinary authority, including the ability to act unilaterally without the consent of the other member(s) of the board of directors. Until she is determined to “lack capacity by an appropriate court of the State of Mississippi,” Ms. Costa has the power that would regularly be exercisable only by an entire board of directors.²⁶ Further, “[t]he Board of Directors shall have no authority with respect to Robin G. Costa to deprive her of, limit, or interfere with the exercise of the powers reserved to her by the incorporators.”²⁷

Likewise, the bylaws of the Maddox Foundation Corporation give Ms. Costa unlimited authority to exercise all of the powers which would otherwise be exercisable only by a board of

²³ See Articles of Incorporation, Appendix at Tab No. 11.

²⁴ *Id.* ¶ 8a.

²⁵ *Id.* ¶ 8c.

²⁶ *Id.* ¶ 8f.

²⁷ *Id.* ¶ 8g.

directors to the exclusion of the other members of the board of directors.²⁸ According to the bylaws, “Costa is exclusively authorized to exercise all of the powers which would otherwise be exercisable by the Board of Directors, whether or not such powers are set forth in these Bylaws.”

The bylaws authorize Ms. Costa to retain all such powers “until she is determined to lack capacity by an appropriate court of the state of Mississippi, resigns, or dies.” . . . Thus, any provision in the law, bylaws, or otherwise, which authorizes or permits the Board of Directors to exercise any powers not enumerated . . . above, whether or not with reference to a prior vote of the Board of Directors, shall be exercisable instead **solely** by Robin G. Costa.”²⁹

At the time of the incorporation of the Maddox Foundation Corporation, Ms. Costa was appointed President, Treasurer, and Secretary, and Ms. Working was appointed Vice President. Pursuant to the bylaws, the officers of the corporation were entitled to compensation for their services.

According to the bylaws, the initial directors, Ms. Costa and Ms. Working, were to hold office on the Board of Directors for a term of five years, which was set to expire on or about September 7, 2004.³⁰ Thereafter, “[s]ince Robin G. Costa is acting in place of the Board . . . she shall have the power to appoint a new Director when a term of an acting Director has expired and can appoint herself, as well as any other Director, for a successive term or terms.”³¹

On December 31, 2000, Ms. Working resigned as Vice President of the Maddox Foundation Corporation. However, pursuant to the temporary restraining order entered by Judge

²⁸ See Bylaws of the Foundation at art. II § 1, Appendix at Tab No. 12.

²⁹ *Id.* (emphasis added.)

³⁰ *Id.* at art. II. § 2.

³¹ *Id.*

Kennedy on September 1, 2004, and the Temporary Injunction entered November 29, 2004, Ms. Working remains a member of the Board of Directors.³²

3. *The transfer of assets from the Foundation to the Corporation*

On July 27, 2001, Ms. Costa, as “managing trustee” of the Maddox Foundation Trust and as a director of the Maddox Foundation Corporation, and Ms. Working, as a director of the Maddox Foundation Corporation, executed an Agreement as to Reorganization of Maddox Foundation (the “Agreement”).³³ The Agreement purported to authorize the Maddox Foundation Trust, pursuant to Section 12 of the Trust Agreement, to transfer to the Maddox Foundation Corporation “its legal and equitable title in any and every asset it presently has or shall be entitled to in the future.”³⁴ Effective August 1, 2001, the Maddox Foundation Corporation purportedly accepted receipt of all of the assets transferred to it by the Maddox Foundation Trust.³⁵

Also as alleged, the Maddox Foundation Trust’s purported transfer to the Maddox Foundation Corporation of “its legal and equitable title in any and every asset it presently has or shall be entitled to in the future” was ineffective as alleged in the lawsuit, because, in addition to those reasons outlined above, Ms. Costa, a non-resident trustee, failed to comply with Tenn. Code Ann. § 35-50-107(b)(2),³⁶ and was therefore not lawfully able to act on behalf of the Maddox Foundation Trust.

³² See Temporary Restraining Order, September 1, 2004, Appendix at Tab No. 13, and Order Regarding Motion for Temporary Injunction, November 29, 2004, Appendix at Tab No. 14, in *State of Tennessee v. Costa*.

³³ See Agreement as to Reorganization dated July 27, 2001, Appendix at Tab No. 15.

³⁴ *Id.* ¶ 1.

³⁵ *Id.* ¶ 3.

³⁶ Tenn. Code Ann. § 35-50-107. **Limitations on appointment of nonresident fiduciary.**

The Maddox Foundation Trust's purported transfer to the Maddox Foundation Corporation of "its legal and equitable title in any and every asset it presently has or shall be entitled to in the future" was also ineffective because the Trust Agreement permits an out-of-state corporation to act as a trustee for and on behalf of the Maddox Foundation Trust, but does not authorize or permit an out-of-state corporation to act as the trust itself.³⁷ The transfer was therefore ineffective because the Maddox Foundation Corporation fails as a trustee since it is a non-resident trustee and it is not authorized by state or federal authorities to exercise fiduciary powers.

Thus, the correct situs for the Maddox Foundation Trust, including the "legal and equitable title in any and every asset it presently has or shall be entitled to in the future," has been, and always has remained in Davidson County, Tennessee.

D. Robin Costa's Management of the Foundation

Timothy J. Pagliara, Managing Partner of Capital Trust Wealth Management, who has been retained as an expert witness by the District Attorney General and Ms. Working in the Tennessee lawsuit, has determined in a preliminary report that Robin Costa, as the managing trustee of the Maddox Foundation and controlling director of the Maddox Foundation

"(b)(2) Any nonresident person, bank or trust company shall not act in any such capacities, until it has appointed in writing the secretary of state as its agent for service of process, upon whom all process in any suit or proceeding against it may be served in any action or proceeding relating to any trust, estate or matter within this state in respect of which such person, bank or trust company is acting in any such fiduciary capacity, and in such writing shall agree that any process against it, which shall be served upon such secretary of state, shall be of the same legal force and validity as if served on such person, bank or trust company. ..."

³⁷ See Action on Written Consent of Trustees dated September 5, 1986, ¶5, Appendix at Tab No. 3; Maddox Foundation Trust Agreement ¶ 12, Appendix at Tab No. 1.

Corporation, breached the standard of care required of fiduciaries in a number of ways which have directly resulted in financial loss to the Foundation.³⁸

Rhonda Sides, a Certified Public Accountant and Director with Crosslin Vaden & Associates, P.C., has reached similar conclusions about Ms. Costa's management of the Maddox Foundation Corporation. Based on her preliminary review of documents provided by the Corporation, Ms. Sides has concluded that:

- The financial statements of the Foundation and its related entities do not accurately reflect the true financial condition or value of the Foundation, its assets and its related entities;³⁹
- Robin Costa has paid herself excessive compensation by taking compensation from the Foundation (premised upon an erroneously high valuation of assets) as well as from at least one of those related entity assets, Margaret Energy. She has also been paid fees as a co-executor of each of the Maddox Estates. As stated in Ms. Sides Affidavit, Robin Costa has been "triple dipping" her personal compensation⁴⁰; and
- The financial records reflect expenditures of Foundation assets exceeding \$6,000,000 for purposes that have no apparent relationship to the charitable purposes of this tax exempt entity.⁴¹

This paper will give a few examples from these reports which are illustrative of the lawsuit's allegations of how Ms. Costa has mismanaged the Foundation.

³⁸ See Affidavit of Timothy J. Pagliara ("Pagliara Aff.") ¶ 5, October 18, 2004, Appendix at Tab No. 16.

³⁹ See Affidavit of Rhonda Sides ("Second Sides Aff.") ¶ 7.A., October 22, 2004, Appendix at Tab No. 17.

⁴⁰ *Id.* ¶ 7.B. (Ms. Costa's total personal compensation out of the Maddox assets is in excess of \$3.5 million).

⁴¹ *Id.* ¶ 7.C.

1. Failure to adopt an investment policy

For years, Ms. Costa operated the Maddox Foundation Trust and the Maddox Foundation Corporation without an established investment policy. Professor Schoenblum testified that he repeatedly and from the very beginning advised Ms. Costa to adopt an investment policy for the Foundation and that, as of late 2001 when he stopped representing the Foundation Ms. Costa still had not adopted an investment policy.⁴² According to Professor Schoenblum,

this goes to the whole concept of proper management of a charitable foundation and also Mr. Maddox's vision of what this foundation would be assuming that Mrs. Maddox would have followed through with his ideas, and that is that you were achieving a move from a relatively small foundation in terms of asset value that was very local in nature to what could have been a really influential foundation on a national or international level with 10 times, 15 times as many assets.

When you have that amounts of assets, you need an appropriate governance structure, and that was the idea of the corporate form. You need guidelines so that you institutionalize or bureaucratize your management. You have to have guidelines so that it transcends the individuals so that it isn't the personal fiefdom of any person but that whoever is there in that role follows expert specific rules of a long-term management of a foundation nonetheless.

It's not what an individual decides based on what the person feels on a particular day when they wake up in the morning or go to bed at night. It's routine, efficient and sensible management, so, for example, when you get to investments, you can't just come up with some hairbrain scheme⁴³

As shown by the Foundation's tax returns, the Ms. Costa's failure to adopt or adhere to an appropriate and/or adequate investment policy has resulted in a significant churning of the investment portfolio and a continued and consistent pattern of investment losses.⁴⁴

2. Failure to divest from American Retirement Corporation

⁴² Deposition of Jeffrey Schoenblum ("Schoenblum Depo."), January 6, 2005, at 182-184, Appendix at Tab No. 18.

⁴³ *Id.* at 184-185.

⁴⁴ See 2000 Form 990-PF, 2001 Form 990-PF, and 2002 Form 990-PF, Appendix at Tab Nos. 19, 20, and 21, respectively; see also *Pagliara Aff. supra*.

Several Nashville businessmen including Dan Maddox formed the American Retirement Corporation. DMAR, a limited partnership owned by Mr. and Mrs. Maddox at the time of their deaths, and one of the numerous entities related to the Maddox Foundation Corporation had significant holdings in American Retirement Corporation (“ARC”). Before the death of Mr. Maddox, Ms. Costa was elected to the ARC Board of Directors. Contrary to the advice of the attorney for the Foundation Trust (and later the Maddox Foundation Corporation), Ms. Costa maintained her position on the Board and audit committee of ARC.⁴⁵ At the same time, despite the actual and apparent conflict of interest, Ms. Costa exercised her authority as Executor/Trustee to retain a significant equity position in the corporation, even as the stock price plummeted. Ms. Costa made it clear to the Maddox Foundation Trust and Corporation’s investment advisors that they were not permitted to sell ARC stock in order that Ms. Costa might be able to preserve her position as a member of the Board of Directors of ARC.⁴⁶

Although Ms. Costa eventually did resign her position as a member of the Board of Directors of American Retirement Corporation, the assets of the Maddox Foundation have been significantly depleted as the ARC stock, which was valued at approximately \$29 million at the time of the death of Mr. and Mrs. Maddox, has lost more than 85% of its value.⁴⁷

3. The purchase of professional sports teams

⁴⁵ See Affidavit of Tommye M. Working (“Working Aff.”) ¶ 54, August 30, 2004, Appendix at Tab No. 22; Working Depo. at 63-64, Appendix at Tab No. 7.

⁴⁶ See Deposition of Sean T. Carey (“Carey Depo.”) at 102-103, Appendix at Tab No. 23. In sworn court filings, Ms. Costa claims that it was her co-executor, Mr. Earl Bentz, who insisted on holding the ARC stock and that, in any event, the stock was thinly traded and the Estates could not have effectively divested their large concentration of shares. Ms. Costa’s defenses are rebutted by the sworn affidavit testimony of Mr. Bentz (see Affidavit of Earl Bentz (“Bentz Aff.”) ¶ 4, Appendix at Tab No. 24) and contradicted by publicly available data reflecting the actual trading volume of ARC stock during the relevant time period.

⁴⁷ See Affidavit of Rhonda Sides (“First Sides Aff.”) ¶ 10, August 30, 2004, Appendix at Tab No. 25.

On July 19, 2002, Ms. Costa incorporated Maddox Hockey, Inc. and Maddox Football, Inc. as wholly owned subsidiaries of the Mississippi non-profit entity.⁴⁸ On September 1, 2002, Ms. Costa executed a “Grant Agreement” as a grantor on behalf of the Maddox Foundation Corporation.⁴⁹ Under the terms of the Grant Agreement, \$1,500,000 of Foundation assets was given to Maddox Hockey and \$601,000 was given to Maddox Football. Ms. Costa thereafter used these Foundation assets and others to purchase and operate the Memphis RiverKings professional hockey team, through Maddox Hockey, and purchase and operate the Memphis Xplorers professional arena football team, through Maddox Football.

Owning these sports teams has been an economic disaster for the Maddox Foundation. The purchase price was well above that recommended by Ms. Costa’s financial and legal advisors. Both teams had significant annual losses in the years prior to their purchase. For example, the RiverKings sustained annual losses of approximately \$1,000,000 prior to the purchase. In the first year following the purchase, the RiverKings lost \$1.4 million and the Explorers lost over \$883,000.⁵⁰ Nevertheless, Ms. Costa continued to use the Maddox Foundation’s assets to fund the operating expenses of these failing professional athletic teams.⁵¹

According to the 2003 Form 990PF, the Maddox Foundation contributed over \$4,000,000 directly to Maddox Hockey, Inc. and Maddox Football, Inc., and paid an additional \$51,000 of expenses associated with the sports entities directly from Foundation assets, while characterizing such expenditures as charitable distributions. By October 2004 the Maddox Foundation had

⁴⁸ *Id.* ¶ 11.

⁴⁹ *See* Grant Agreement dated September 1, 2002, Appendix at Tab No. 26.

⁵⁰ *See* Maddox Hockey, Inc. 2002 Form 1120 and Maddox Football, Inc. 2002 Form 1120, Appendix Tab Nos. 27 and 28, respectively.

⁵¹ *See* First Sides Aff. ¶ 14, Appendix at Tab No. 25.

incurred over \$8,000,000 in debt through draws on a line of credit with Merrill Lynch, the proceeds of which have reportedly been used to fund the operations of these “for profit” sports teams.

A complete assessment of how trust assets have been poured into these professional sports teams must await completion of the court ordered accounting. However, the information disclosed in the Foundation tax returns and financial statements indicate that in two and a half years, more than \$8 million, which otherwise would have been available to support charitable works and causes, has been spent on the business of minor league hockey and arena football.

Neither of the investments in professional athletic teams meets the Maddox Foundation’s athletic purposes, which are restricted to the “fostering of national or international amateur sports competition.”⁵² Nor are they compatible with the purposes of the Maddox Foundation Trust. Likewise, the investments are not in the best interest of the beneficiaries of the Maddox Foundation Trust and would jeopardize the carrying out of any of the exempt purposes of the trust.

In fact, prior to the purchase of these sports teams, Ms. Costa was advised by legal counsel to obtain a private letter ruling from the IRS to determine whether or not the investment could meet a narrow exception so as to be classified as “program related,” thereby avoiding significant tax penalties.⁵³ Ms. Costa has yet to obtain such a private letter ruling from the IRS and did not even request such a private letter ruling until more than a year after she purchased the

⁵² See Articles of Incorporation ¶8a, Appendix at Tab No. 11 (emphasis added).

⁵³ Carey Depo. at 66-68, Appendix at Tab No. 23.

two professional sports teams.⁵⁴ This is contrary to the position taken by Professor Schoenblum, who testified:

A: . . . I would not ever advise using funds to invest in professional athletics without a private letter ruling.

Q: Without obtaining a private letter ruling before making the investment or at any time?

A: Well, the way I practice law, before making that kind of investment, because I believe that is so questionable and there is so little authority justifying it that I would be very hesitant to advise any client to do that first and then seek a ruling because of the consequences if you got an unfavorable ruling and had to unwind all of that.⁵⁵

Although Professor Schoenblum did not advise Ms. Costa on the purchase of the hockey and football teams, based on his experience advising her concerning the Foundation for several years he testified that, “as a general matter, I would have looked at it with an extremely jaundiced eye. That’s not to say that it’s inconceivable, but I think it’s highly unlikely that I would have ever said that that’s an appropriate investment.”⁵⁶

Outside attorneys for the Maddox Foundation Corporation advised Ms. Costa against serving as a member of management for either professional sports teams.⁵⁷ However, Ms. Costa refused to follow their advice, and serves as the chief executive officer and president of the RiverKings and the operator of the Xplorers.⁵⁸

Ms. Costa also holds herself out to the public as the owner of these professional athletic teams. According to a press release dated August 17, 2002, announcing the purchase of the

⁵⁴ *Id.* at 69.

⁵⁵ Schoenblum Depo. at 113, Appendix at Tab No. 18.

⁵⁶ *Id.* at 120.

⁵⁷ See Polsinelli Shalton & Welte memorandum dated July 3, 2002, Appendix at Tab No. 29.

⁵⁸ See team management rosters, Appendix at Tab Nos. 30 and 31, respectively.

hockey team, Ms. Costa “fell in love with hockey and with the RiverKings,” and, “[a]s a new owner, you’ll see a lot of me.”⁵⁹ Ms. Costa’s “two children are major hockey fans.”⁶⁰ Ironically, in emails written before she used the Foundation’s assets to buy the hockey team, Ms. Costa wrote: “I do not like hockey. I’ve never been to a hockey game previously. I’m not a [R]iverkings fan. I don’t know any of the players or the people involved.”⁶¹

4. *Robin Costa’s excessive expenditures of Foundation assets*

According to its Form 990-PF, the Maddox Foundation Corporation held assets totaling only \$39,598,321 at the end of 2000.⁶² The grants made by the Maddox Foundation Corporation in 2000 totaled \$1,868,424, while its total operating expenses were \$1,900,801-- \$32,000 more than its charitable gifts. The Maddox Foundation Corporation’s operating expenses in 2000 included \$516,000 in compensation to its officers, \$503,000 in compensation to its attorneys, and \$244,000 in compensation to its accountants and financial advisors. Realized capital losses for 2000 were \$212,885.

In 2002, Belmont University in Nashville, Tennessee received a \$500 cash donation, but the Foundation also counted as a charitable distribution to Belmont \$4,650 of chartered airplane expenses for two round trips to Nashville, one of which reportedly was to deliver the \$500 check.⁶³

⁵⁹ See Press Release, August 17, 2002, Appendix at Tab No. 32.

⁶⁰ *Id.*

⁶¹ See Schoenblum Depo., Exhibit 123, Appendix at Tab No. 18. Whether the statement in her e-mail was true at the time she wrote it, she quickly changed her position and became well acquainted with players and employees of the hockey team. So well acquainted in fact that one of her relationships with a hockey team employee has resulted in a sexual harassment lawsuit against her and the Foundation.

⁶² See 2000 Form 990-PF, Joint Appendix at Tab No. 19.

⁶³ See 2001 and 2002 Forms 990-PF, Appendix at Tab No. 20 and 21, respectively.

A comparison of the Maddox Foundation Corporation's operations over time reveals the effect of Ms. Costa's management of the Foundation's assets:⁶⁴

	2000	2001	2002	2003
Assets a Year End (Fair Market Value)	\$39,598,321	\$49,239,122	\$40,869,475	\$118,290,116 ⁶⁵
Contributions Reported by Foundation	\$1,868,424	\$1,584,372	\$2,841,310	\$5,524,509 ⁶⁶
Operating Expenses	\$1,900,801	\$1,463,751	\$2,155,136	\$2,092,869
Legal Fees	\$503,859	\$368,491	\$412,690	\$486,340
Officer Compensation (Costa) ⁶⁷	\$305,981	\$275,828	\$276,346	\$276,342
Accounting Fees	\$79,680	\$162,070	\$169,900	\$123,085
Financial Advisors/Other Professional Fees	\$164,532	\$150,677	\$216,864	\$177,126

Strikingly, in 2002, the value of the Maddox Foundation Corporation's assets dropped by more than \$8,000,000, while its operating expenses increased by 47%. There is even more to see when one looks deeper into these numbers. One of the recipients of Ms. Costa's largesse in 2002 and 2003 was the Community Foundation of Northwest Mississippi, ("CFNM"). In 2002, the Maddox Foundation claimed a charitable distribution to CFNM in the amount of \$98,206. According to CFNM's public filings, much of this support came by way of payments to "third parties." An examination of the Maddox Foundation's general ledger for 2002 reveals that \$59,114 was spent to put on a lavish party – dubbed the "Crystal Ball" – that according to the

⁶⁴ See 2000, 2001, 2002, and 2003 Forms 990-PF, Appendix at Tab Nos. 19, 20, 21 and 33, respectively. The 2004 Form 990-PF is not yet available.

⁶⁵ This reflects the transfer of assets from the DWM and MHM Estates.

⁶⁶ It should be noted that over \$4,000,000 of this amount was paid by the Foundation directly to Maddox Hockey, Inc. and Maddox Football, Inc. to cover the teams' operating losses, yet the Foundation claimed a charitable deduction for these payments on its 2003 Form 990-PF. See 2003 Form 990-PF, Appendix at Tab No. 33.

⁶⁷ See Defendants' Responses No. 4, Appendix at Tab No. 6. At the same time she was paying herself compensation to manage all of the Foundation assets, she was paying herself additional annual compensation (\$125,000, \$150,000, and \$150,000 from 2001 to 2003) out of one of the investment holding companies owned by the Foundation, as well as paying herself executor and trustee fees.

CFNM's tax return only raised approximately \$4,000 in disposable funds. The remaining \$39,092 of the Foundation's distribution was supposedly to pay expenses directly on behalf of CFNM, however over \$11,500 was incurred for charter plane trips and \$9,300 was spent to produce a promotional film.

The year 2003 saw a repeat of this practice on a larger scale, with the Maddox Foundation claiming cash contributions of \$50,000 and \$124,442 in expenses for CFNM. According to CFNM's 2003 Form 990, that year's Crystal Ball cost \$78,712 and did not raise any money.⁶⁸ Nevertheless, in 2002 and 2003 Ms. Costa characterizes these party extravaganzas as charitable contributions.

In 2003, the Maddox Foundation reported charitable contributions of \$5.52 million, \$124,442 of which was for CFNM's expenses and over \$4.1 million consists of payments to cover the operating losses of the hockey and football teams. This leaves, at best, only \$1.3 million in genuine charitable contributions – which is \$700,000 less than the Foundation's reported operating expenses.

Compared to lavish parties, chartered plane trips, and the expenses of operating minor league sports teams, the amount of money the Foundation, under Ms. Costa's leadership, actually provides to charitable purposes is small indeed.

5. Robin Costa's compensation

In 2000, Ms. Costa asked Professor Schoenblum, in his role as an attorney for the Maddox Foundation, to conduct a survey to determine an appropriate salary for Ms. Costa. Professor Schoenblum retained an independent consulting firm which determined a range of compensation. He then determined that an appropriate annual salary for Ms. Costa was

⁶⁸ See 2003 Form 990, Community Foundation of Northwest Mississippi, Appendix at Tab No. 34.

\$275,000, based on information provided to him by Ms. Costa that all of the Maddoxes' assets had been transferred to the Maddox Foundation, and that such assets would have had a value of approximately \$180 million.⁶⁹ As Professor Schoenblum testified, while there are many factors that must be considered in determining Ms. Costa's compensation, he "believe[s] that asset value was a critical factor, the critical factor."⁷⁰

However, as it became clear later, Professor Schoenblum had not been given all of the relevant or current information on the value of the assets in the Foundation. As he testified, he

never saw any documents, in fact, at various points [I] basically was begging for that information, but I never really got that information. And that's why I had these caveats later on, because I had reached a conclusion that I personally could not make a determination in Nashville, Tennessee, what was going on, what they were doing, and so, therefore, I would give advice, but I would give advice with great caution telling them you really have to – I hope you're really doing this at this level because this is the number we're relying on, and if this is not the number then obviously the report isn't worth the paper it's written on.⁷¹

By the time he was asked to do a second compensation report for Ms. Costa, Professor Schoenblum had learned that the Maddox Foundation Corporation did not have assets valued at \$180 million.⁷² The Form 990-PF for 2000 shows compensation to Ms. Costa of \$305,981, however, the Maddox Foundation had assets at the end of December 2000, of only approximately \$38 million — more than \$100 million less than the amount on which Ms. Costa's salary was based.⁷³ In fact, had Ms. Costa asked Professor Schoenblum to prepare a third compensation report he would have refused to do so "[b]ecause at the time it would have come

⁶⁹ See Schoenblum Depo. at 40-51; Exhibit 110-B (compensation report), Appendix at Tab No. 18.

⁷⁰ *Id.* at 50.

⁷¹ *Id.* at 53-54.

⁷² *Id.* at 54, 158-159, 169-176, Exhibits 136, 137 (second compensation report).

⁷³ *Id.* at 163-164, Exhibit 135.

up, I had reached the conclusion that the representations that she was making [as to asset value] were just too unreliable for me to put my name to a formal compensation report.”⁷⁴

In addition, Ms. Costa paid herself salaries from numerous other sources, which she controls through her management control of the Maddox Foundation, including the Maddoxes’ estates, the Maddox Revocable Trusts, and at least one subsidiary of the Revocable Trusts and the Maddox Foundation Corporation, Margaret Energy, Inc. For the period 1998 through 2003, Ms. Costa paid herself a total of \$3,263,943 in compensation from all of the Maddox-related entities.⁷⁵ The Maddox Foundation owns or has a controlling interest in all of these various entities, which are supposed to be held for the benefit of charitable beneficiaries.

6. Travel and other personal expenses

In 2002, the Maddox Foundation Corporation provided a computer-training seminar to its 4-person staff in Cancun, Mexico. The training, which consisted of a 2-day course, could have been conducted at the Foundation’s offices. One Foundation employee has testified that she was the only one who attended seriously and that Ms. Costa and the other employee-attendees arrived late and drank throughout the first day:

And they continued this all day. Any break that we had, they would go to the bar and get drinks. At lunch they drank some more. So by the afternoon it was apparent that they were intoxicated, and they were slurring their speech, they were acting silly, they weren’t following the instructor.

...

And the next day we had class again, which this time they did not drink, but they were – you could tell they were hung over. And we had our class that day. And then the next day was a free day, so we did some touring in the area and then the next day we came home.⁷⁶

⁷⁴ *Id.* at 182.

⁷⁵ *See* Defendants’ Responses No. 4, Appendix at Tab No. 6.

⁷⁶ *See* Deposition of Tara Hermansen (“Hermansen Depo.”), at 35-37, Appendix at Tab No. 35.

The Foundation paid for the employees' and their families' airfare, the all-inclusive resort, and the transportation between the airport and the resort.⁷⁷

Similarly at Ms. Costa's direction, the Foundation paid for Ms. Costa and the Foundation's accountant to attend a seminar in California in May of 2002. An employee has testified that Ms. Costa spent most of the "business trip" on shopping activities.⁷⁸ Ms. Costa has used funds from the Foundation to charter jets to Knoxville, Tennessee, to attend University of Tennessee football games in 2000 and 2001.⁷⁹

Since purchasing the hockey team in 2002, Ms. Costa has chartered jets to fly to hockey games using funds directly or indirectly held for the Maddox Foundation. A former employee of Maddox Hockey testified in his deposition that it is highly unusual for team owners in that league and similar leagues to travel to away games with the team due to budgetary constraints. In addition, even though team members received a per diem, Ms. Costa would buy meals for the team using her Foundation credit card.⁸⁰

Ms. Costa also chartered a private jet to attend President Bush's inauguration in January 2001, billing the cost of the trip to the Maddox Foundation.⁸¹ According to Maddox Foundation Corporation 2002 accounting records, over \$19,000 was expended on chartered air travel.

⁷⁷ *Id.* at 38.

⁷⁸ *See* Working Aff. ¶ 77, Appendix at Tab No. 22.

⁷⁹ Hermansen Depo. at 23-25, Appendix at Tab No. 35.

⁸⁰ *Id.* at 62-63.

⁸¹ *See* Second Sides Aff, Preliminary Report, Appendix at Tab No. 17. A recent news story suggests that Ms. Costa and her representatives have provided contradictory explanations for this trip. *See e.g.* Stephanie Strom, *After Donor Dies, Battle Erupts Over Fund's Vision and Venue*, N.Y. TIMES, February 16, 2005 at A1, Appendix at Tab No. 36.

According to credit card expense reports during 2003 and through April 2004, the Foundation incurred over \$46,000 of airfare expenses.⁸²

The Maddox Foundation Corporation has paid for Ms. Costa's cell phone charges, according to its credit card expense reports for 2003 and 2004.⁸³ Maddox Foundation Corporation credit card expense reports for employees for 2003 and through July 2004 reflect various medical expenses, gas charges, florist charges, and pet store and product charges.⁸⁴

According to credit card expense reports of the Maddox Foundation Corporation:

- on a total of seven occasions between May 2003 and July 2003, officers and/or employees of the Maddox Foundation Corporation charged a total of almost \$8,000 in expenses at the Gold Strike Casino in Tunica, Mississippi, to the Maddox Foundation Corporation.⁸⁵
- in November 2003, officers and/or employees of the Maddox Foundation Corporation charged a total of over \$4,000 in expenses at the La Costa Resort and Spa to the Maddox Foundation Corporation.⁸⁶
- in May 2004, officers and/or employees of the Maddox Foundation Corporation used Foundation assets to purchase approximately \$13,000 of bronze statuary at the Carlton Gallery, in La Jolla, California to decorate the Maddox Foundation Corporation

⁸² *Id.*

⁸³ *Id.* ¶ 25.

⁸⁴ *Id.*

⁸⁵ *Id.* ¶ 27. In sworn Court filings, Foundation employee Paul Morris claims this expense was incurred to provide lodging for players of visiting hockey teams. While this may be a legitimate business expense for the RiverKings hockey operation, it is *not*, as Ms. Costa reports on the Foundation's tax return, a charitable contribution.

⁸⁶ *Id.* ¶ 28.

headquarters.⁸⁷

E. Tennessee charities suffer

The actions described above, which are part of the lawsuit, are not abuses for which there are no victims. Assets which Dan and Margaret Maddox intended to be used to alleviate need and promote beneficial social programs in Tennessee have been taken to another state and squandered. The amount of charitable donations claimed by the Foundation on its tax returns is misleadingly inflated by the inclusion of expenses such as charter plane trips, catering and party accessories as well as the multi-million dollar operating losses of the two sports teams. These excesses have had a direct negative impact on Tennessee charities that were the intended beneficiaries of the Maddox's legacy. All the while, Ms. Costa has paid herself millions in compensation out of assets that were intended by Mr. Maddox, the person who earned them to support charities in his "wonderful Nashville community."

During their lifetimes, Dan and Margaret Maddox were significant and generous supporters of Covenant Presbyterian Church in Nashville, having pledged \$1,000,000 of their personal funds to the Church's building campaign.⁸⁸ Shortly after Dan and Margaret Maddox were killed, Ms. Costa and Ms. Working met with the Rev. James Bachmann and Mr. Clarence Southerland, a close friend of the Maddoxes.⁸⁹ At this meeting Ms. Costa and Ms. Working orally committed to make a contribution to the Church in memory of the Maddoxes in an amount "between two and four million dollars."⁹⁰ Time passed, Ms. Costa procured the relocation of the

⁸⁷ *Id.* ¶ 29.

⁸⁸ *See* Affidavit of S. James Bachmann, Jr., September 27, 2004, Appendix at Tab No. 37.

⁸⁹ *Id.* ¶ 6, 7.

⁹⁰ *Id.*

Foundation to Mississippi, and no payment on the pledge was ever made.⁹¹ Eventually, Rev. Bachmann wrote to Ms. Costa asking about the pledge only to be informed by Ms. Costa that the Foundation did not have the assets with which to satisfy the pledge.⁹² After Ms. Costa had cemented her control over the Foundation, it made a single contribution of \$5,000 to the church.⁹³ Ms. Costa referred to such contributions as “GAG Gifts”; her acronym meaning “go away gifts.”⁹⁴

The Second Harvest Food Bank is one of Nashville’s most valuable charities. It provides food for hungry families and for many it is the difference between health and starvation. In August 2000, after the Maddoxes’ assets were moved to Mississippi, William G. Coke, Jr., wrote to the Maddox Foundation requesting its assistance in Second Harvest’s capital campaign to build a new warehouse in Nashville. Ms. Costa replied to Mr. Coke in January, 2001 refusing Second Harvest’s request claiming that “it is the current mission of the foundation to significantly impact Mississippi as a positive catalyst for addressing community needs.” An attorney for the Foundation also wrote to Mr. Coke stating “the focus of the foundation has significantly changed since it moved ...”⁹⁵ Eighteen months after denying the Second Harvest Food Bank’s request for assistance in building a warehouse for its charitable food distribution program, Ms. Costa spent nearly \$2,000,000 to purchase the sports teams.

Another object of Dan Maddox’s generosity during his lifetime was the Lewis County Museum, a project of the Lewis County, Tennessee Historical Society. Before his untimely

⁹¹ *Id.* ¶¶ 8, 9.

⁹² *Id.* ¶10.

⁹³ *Id.* ¶11.

⁹⁴ Hermansen Depo. at 22-23, Appendix at Tab No. 35.

⁹⁵ *See* Affidavit of William G. Coke, Jr., October 12, 2004, Appendix at Tab No. 38.

death, Mr. Maddox committed to donate \$2,000,000 to the Historical Society for its capital campaign. Based on this pledge, the Historical Society made commitments to purchase land and undertake building improvements for the Museum. After Mr. and Mrs. Maddox were killed, Ms. Costa acknowledged the existence of this pledge to Tony L. Turnbow, Chairman of the Board of Trustees of the Lewis County Museum; however, she has not honored that pledge and has since informed Mr. Turnbow that Maddox Foundation gifts to charities in Middle Tennessee would be limited to the discretionary funds given to the Community Foundation of Middle Tennessee and further limited to \$5,000. Because of these actions by Ms. Costa the Lewis County Museum has been unable to raise the funds necessary to construct the facility the Maddoxes supported during their lifetime.⁹⁶

CORRECTIVE ACTION

In late 2000, Ms. Working resigned as Vice President of the Maddox Foundation Corporation and returned to Nashville. As she testified in her deposition, Ms. Working resigned because she did not believe that the Foundation was being run as her grandparents would have wished it to be run.⁹⁷

Because of her concern over Ms. Costa's management of the Maddox Foundation Corporation, and because she remained a Director of the Corporation, Ms. Working continued to attempt to stay involved in running the Corporation. However, as she had while Ms. Working lived in Mississippi,⁹⁸ Ms. Costa actively frustrated Ms. Working's attempts to learn about the

⁹⁶ See Affidavit of Tony L. Turnbow, October 13, 2004, Appendix at Tab No. 39.

⁹⁷ Working Depo. at 44-45, Appendix at Tab No. 7.

⁹⁸ Tara Hermansen testified that "Robin told me and the other girl that was there if Tommye Working called that we were not to give her any information, we were not to tell her where Robin was or what she was doing, that we would only take a message. I would sometimes put Tommye through to Robin's voice mail and then later on Robin told

Corporation's financial status or internal operations.⁹⁹ Finally, out of concern that her grandparents' legacies were being wasted by Ms. Costa, Ms. Working contacted District Attorney General Johnson in Nashville.

After investigating Ms. Working's concerns, District Attorney General Johnson authorized the filing of a lawsuit in the Probate Court in Nashville seeking to have the assets held by the Maddox Foundation returned to Tennessee, remove Ms. Costa as a fiduciary over those assets, have an accounting of the Foundation's assets, and other related remedies. Because of his office's resources and pressing responsibilities, General Johnson authorized our law firm, Waller Lansden Dortch & Davis, PLLC, to prosecute the Tennessee action on behalf of the State of Tennessee. While Ms. Working certainly does plan on petitioning the probate court for reimbursement of her legal fees out of the Maddox Foundation assets, to date Ms. Working has paid for Waller Lansden's services out of her own pocket.

It is important to keep in mind that Ms. Working's prosecution of this lawsuit is not being done for her personal gain. This lawsuit was filed to protect Maddox Foundation assets, which are currently held by a Mississippi non-profit corporation, for the benefit of the rightful beneficiaries, *i.e.*, the charities of Middle Tennessee. In fact, even if Ms. Working were to prevail in this matter on the claims advanced by her in the Complaint, she would not receive any monetary compensation. Ms. Working is not seeking monetary damages in her individual capacity. Nor is she seeking to insert herself in Ms. Costa's stead at the helm of the Maddox Foundation Corporation. She only wants what her grandparents wanted – to bring the

me not to put her through to her voicemail, to just take a message.” Hermansen Depo. at 47-48, Appendix at Tab No. 35.

⁹⁹ See Working Depo. at 225-228, Appendix at Tab No. 8.

Foundation back to Middle Tennessee and to have it properly managed “to help in Nashville’s problems and to make a big positive difference in a lot of youngster’s lives.”

In attempting to reach that goal, Ms. Working and District Attorney General Johnson have been opposed at every corner by both Ms. Costa and the Maddox Foundation Corporation. Ms. Costa and the Maddox Foundation Corporation attempted, albeit unsuccessfully, to dismiss the Tennessee lawsuit on jurisdiction grounds.¹⁰⁰ They unsuccessfully opposed the State’s motion seeking to require prior Court approval of the use of trust assets to pay attorney fees and litigation expenses. Most recently, Ms. Costa and the Maddox Foundation Corporation unsuccessfully opposed the Davidson County Probate Court’s appointment of a special fiduciary to conduct an accounting. This accounting is currently ongoing.

The one forum where Ms. Costa has enjoyed any success is in the Chancery Court of DeSoto County, Mississippi, which is the same County that is home to Foundation Corporation headquarters. Although nominally designated as a defendant by the Mississippi Attorney General, Ms. Costa actively sought to be enjoined by the Mississippi State Court from complying with the orders of the Tennessee Probate Court. Ms. Working, who was also named a defendant in the Mississippi litigation, has removed the case to federal court in Jackson, Mississippi. As of the date this testimony was prepared, the State of Mississippi’s motion to remand the case is still awaiting a ruling by the U.S. District Judge.

POLICY CONSIDERATIONS

We believe that many of the proposals discussed in the Senate Finance Committee staff discussion draft [108th Cong. (2004)] could have deterred or prevented the abuses that have

¹⁰⁰ The jurisdiction of the Davidson County, Tennessee Probate Court cannot be seriously questioned. Ms. Costa is an executrix of the Maddoxes’ estates which are being administered in Davidson County and have never been closed.

occurred in the Maddox Foundation as alleged in the lawsuit. Our recommendations and observations in this written testimony are limited to the proposals as applied to the facts we have encountered in the Maddox Foundation case. Our firm represents several private non-operating foundations. The donors and trustee/board members of these family foundations take great pride in their ability to maximize the amount of funds distributed to publicly supported charities each year and to minimize expenses. Furthermore, these individuals are very careful not only to comply with the provisions of the Internal Revenue Code but also to fulfill their fiduciary duties and obligations to the class of charities that their foundations are intended to benefit.

We believe the following proposed reforms (listed in the order as presented in the staff discussion draft) could have mitigated, deterred or may have prevented the abuses seen in the Maddox Foundation. We do not reference the proposals that are inapplicable to our case.

1. 5-Year Review of Tax-Exempt Status: We recommend the Service review the tax-exempt status of private non-operating foundations every five (5) years. We believe that there are few citizens like Tommye Maddox Working, who have the interest, willingness and resources to pursue corrective action of foundation abuses. If Ms. Working had not brought the matter to the attention of the District Attorney and agreed to fund the litigation, we do not believe that the Maddox Foundation abuses would ever have been exposed. Adopting this proposal may increase the likelihood that abuses will be identified, corrected and stopped.

2. Increase in Taxes on Self-Dealer and Foundation Manager: This proposal, if enacted, might have a deterrent effect on others who find themselves in positions of control, like Ms. Costa, from entering into abusive self-dealing transactions.

3. Increase Taxes on Foundation Manager for Jeopardizing Investments: We believe that the facts suggest Ms. Costa caused the Foundation to purchase the two sports teams

primarily for her personal enjoyment rather than for any charitable purpose. The acquisition of the teams subjects the Foundation to penalties for jeopardy investment, excess business holdings and taxable expenditures and jeopardizes the Foundation's tax exempt status. Because she sought legal advice and such advice quantified the potential excise taxes, we believe that Ms. Costa might have been deterred if she, as a Foundation Manager, would have been subject to substantial penalties for investing Foundation funds in the sports teams. At the very least, she hopefully would have sought a private letter ruling prior to entering into the purchase of the sports teams, and at best, perhaps she would have dropped the idea entirely.

4. Compensation of Private Foundation Trustees/Directors: We believe compensation reform is necessary. Through 2003 Ms. Costa received \$3.2 million in total compensation from the Foundation and affiliated entities. As stated above, Ms. Costa received \$1,168,620 in compensation from the Maddox Foundation, in part, based on the value of assets not held by the Foundation but held by the Maddoxes' estates. In addition, Ms. Costa paid herself \$1.3 million from the Maddoxes' estates which appear to have been calculated on the value of the estates' assets, and she paid herself a total of \$425,000 from an Estate/Foundation for-profit subsidiary. We believe Ms. Costa's opportunity to pay herself such compensation would have been significantly reduced by adoption of this proposal. Under this proposal, Ms. Costa would not have been in the position to have determined her own compensation.

5. Compensation of Disqualified Persons: Given that Ms. Costa has been both a controlling director and officer (President, Treasurer and Secretary), this proposed reform would have required Ms. Costa to make a choice of either being a director/trustee or a foundation manager. If she chose to be the foundation manager, an independent board would have to

approve her compensation. The likelihood of “triple-dipping” and excessive compensation would be significantly reduced by this proposed reform.

6. Treatment of Administration Expenses of Non-Operating Foundations (i.e., 10% and 35% Thresholds): We believe this proposal would have been very beneficial in the Maddox Foundation case as a deterrent to Ms. Costa incurring such high administrative expenses. If not a deterrent, we believe the proposal could have the utilitarian effect of spotting foundation abuses for remedial action by the Service.

7. Limit Amounts Paid for Travel, Meals and Accommodations: Like the immediately preceding reform, we believe this proposal would have curtailed and/or severely limited Ms. Costa’s lavish spending.

8. Provide States the Authority to Pursue Federal Actions (with the Approval of the Internal Revenue Service): We recommend adoption of this reform. District Attorney General Johnson could have included claims of federal tax law violations in the Tennessee lawsuit if he had the authority this proposal would confer. Tennessee has enacted a statute adopting the prohibited transaction rules for private foundations although there has never been a Tennessee reported case enforcing such law.

9. Require Signature by Chief Executive Officer: This proposal would require a certification by the exempt organization CEO that processes and procedures have been put into place to ensure the accuracy of the organization’s tax return. The effectiveness of this requirement depends upon the quality of third-party review of the organization’s financial information. In this regard, this proposal will have greater effect if it is coupled with other proposed reforms such as those requiring periodic independent audits and disclosure of insider

transaction. Without these additional reforms, merely requiring the CEO's signature on the tax return will not be enough to effectuate genuine reform.

10. Electronic Filing (and Coordination with State Officials): We recommend this reform. It has been difficult to receive information from the Foundation. There is limited information about the Foundation's finances available on the Internet. Even though the Foundation is a private non-operating foundation, which does not carry on any unrelated trade or business activities, Ms. Costa required employees to sign confidentiality agreements. Furthermore, Ms. Working, as a director, was refused information she otherwise was entitled to receive under the law unless she signed a confidentiality agreement. Obtaining information through the discovery process in litigation is very expensive and time consuming.

11. Standards for Filing (990PF): We endorse this proposal. The financial standards and disclosures proposed in the discussion draft would promote uniformity in the presentation of financial information and would facilitate regulatory oversight.

12. Independent Audits or Reviews: This reform would have been extremely helpful in our case. The Maddox Foundation had never been audited. We have received financial statements through the discovery process which are not accurate. The Foundation has double booked certain assets, has over-stated the value of other assets, and has failed to account accurately for its liabilities. In one financial statement the outstanding balance of the Foundation's line of credit loan was understated by \$3,000,000. Tax-exempt status is a public franchise. The public has a compelling interest in the accuracy and completeness of the financial reporting of entities which hold that franchise. Requiring periodic independent auditing is a reform that will go a long way towards assuring the public that this franchise is not being abused.

13. Enhanced Disclosure of Related Organizations and Insider Transactions: This proposal includes enhanced disclosure of related organizations; affiliated entity chart; reporting of taxable subsidiaries; reporting of transactions with subsidiaries; reporting of insider dealings; reporting of joint ventures; reporting of partnership interests and exempt entity's role in the partnership. All of these reforms would have been beneficial in the Maddox Foundation case. It is obvious to us that the Foundation has tried to operate in a climate of secrecy which allowed the abuses to continue for several years without detection. Requiring more disclosure, thus promoting transparency, could have helped avoid the Maddox Foundation abuses. The enhanced disclosure could also be a deterrent from entering into various abusive transactions.

14. Disclosure of Performance Goals: One of the themes that runs through the reforms proposed by this Committee's staff is greater transparency. The same public interest that justifies regular audits, governance standards and compensation reform also supports this and other measures calculated to enhance regulatory oversight.

(a) Disclosure of Material Changes in Activities or Structure: We believe this proposal would have been very beneficial in our case and we would suggest that such disclosure include advance notice of intent to change situs. Foundations also should be required to file the disclosure with state or local authorities. Moreover, exempt entities should be required to affirmatively warrant that they are in compliance with all applicable state laws. This reform, coupled with empowering state authorities to enforce federal tax law claims would provide state regulators with a powerful oversight tool.

15. Disclosure of Financial Statements. We absolutely endorse this proposed reform. The Maddox Foundation operated in a culture of secrecy until the State of Tennessee's lawsuit brought about a court-ordered accounting. The effectiveness of this proposed reform will be

enhanced if the IRS is empowered with the authority to impose uniform standards regarding the content and format by which exempt organizations present their financial statements to the public.

16. Encouraging Strong Governance and Best Practices for Exempt Organizations (Including Defining Board Duties, Board Composition, Board/Officer Removal, and Encouragement of Best Practices): The Maddox Foundation's facts and circumstances are the "Poster Child" for why these reforms should be enacted. We believe that a uniform requirement that the governing board be comprised of at least 3 members should be required. We believe the facts demonstrate that the primary purpose for the Foundation being hijacked to Mississippi was for Ms. Costa to have the sole control over the Foundation because Mississippi only required one governing board member. Ms. Costa was President, Treasurer, Secretary and has sole authority over the Foundation. These circumstances created an environment of no accountability allowing the Foundation, as a practical matter, to answer to no one.

Obviously, issues of federalism arise whenever national standards are contemplated in an area that has historically been the subject of regulation by the states. These reforms are no different. Indeed, the role of the states in oversight and enforcement will continue to be vitally important. Considerations of federalism should be respected and can be accommodated.

Individual states may make different policy choices in regards to the conditions they impose on the tax exempt franchise. For example, the people of Tennessee, through their elected representatives, have decided to require that not-for-profit corporations have no fewer than three directors. The people of Mississippi have decided only to require a single director. Each of these policy choices are equally valid and it is not the role of the federal government to impose a "one-size-fits-all" system.

Nevertheless, the federal government, like the individual states, has the right and obligation to place appropriate conditions on its grant of a tax-exempt franchise. These competing interests can be reconciled, however, by permitting private foundations and public charities the option of being exempt from state taxes but not exempt from federal taxes, if the governance and accountability regimes are different between the sovereigns. For example, a foundation may wish to organize as a not-for-profit corporation under Mississippi's current law, and be exempt from that state's property taxes, sales and use taxes, and franchise and excise taxes, but not be exempt from federal income taxes. Allowing such a result would promote federalism while still creating national standards.

17. Establish Prudent Investor Rules: We believe this reform should be adopted. The Foundation's former legal advisor, Professor Schoenblum, has testified that he repeatedly urged Ms. Costa to adopt an investment policy but as late as 2001 she had not done so. Timothy J. Pagliara, an expert retained by the plaintiffs in the Maddox lawsuit, has opined that the Foundation operated without an investment policy at all, then failed to follow the policy later adopted. Moreover, we believe the schedules to the Form 990PF show that investment accounts were excessively churned. In several years the entire value of the portfolio was traded with many transactions being only days apart. Tennessee's prudent investor rule applies to the Maddox Foundation Trust but not to the Mississippi corporation Ms. Costa created. With this proposed reform, however, regulators in every state would be able to address the abuse that arises from the absence of an investment policy.

18. Funding of Exempt Organizations and for State Enforcement and Education: We are very much in support of this proposal. Ms. Working brought information of the Maddox Foundation's abuses to the attention of authorities in Mississippi and Tennessee. However, like

substantially all of the other states, there are little or no public funds available to police private non-operating foundations. To date, Ms. Working has funded the costs of the litigation, benefiting the State of Tennessee and the Tennessee charities that are the intended beneficiaries of Dan and Margaret Maddox. The current system of bringing foundation abuses to light and correcting the abuses is very inefficient. We have found public officials in our state to be keenly interested in performing a regulatory function, but the resources necessary to achieve an appropriate level of oversight are scarce.

(a) Exempt Organization Hotline for Reporting Abuse and Complaints: We are in support of this proposal. We believe that this proposal would have given the former employees of the Maddox Foundation the opportunity to report the abuse if the hotline had been available, even though the employees were subject to confidentiality agreements.

(b) Information Sharing with State Attorney General: This initiative would have been helpful in obtaining information from the Maddox Foundation instead of having to obtain the information through costly discovery.

19. Tax Court Equity Authority and Private Actions; Private Relator Actions: We favor the proposal to expand the equitable powers of the Tax Court. Those contemplated remedies are, in many ways, duplicative of the remedies available under Tennessee's *quo warranto* statute. Nevertheless, this reform would create an alternative forum for private parties and relators. Moreover, the possibility of removal of an action from state court to the U.S. Tax Court may also be an efficacious reform, particularly where, as in the Maddox Foundation case, competing state court actions are pending.

Allowing private actions to be brought by directors/trustees as well as by private relators will also promote accountability and oversight of exempt entities and relieve the burden on finite state resources.

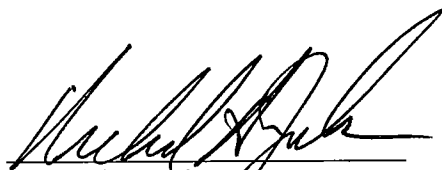
CONCLUSION

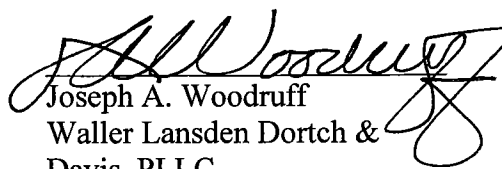
The Maddox Foundation litigation has provided a glimpse into practically every form of excess and abuse of the tax exempt status of private non-operating foundations identified in this Committee's staff report. Those excesses and abuses have highlighted the need for legislative reform.

Private foundations, public charities and other tax exempt entities perform vital services in our society and contribute to enhance the quality of life in communities all across the United States. The abuses occurring in the Maddox Foundation are news mainly because they are the exception and not the norm. Nevertheless, they are abuses that are as hard to correct as they are shocking.

Common sense reforms, such as those under consideration by this Committee, will make the job of state regulators easier and will add to the tools available to protect charitable beneficiaries.

Respectfully submitted,


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