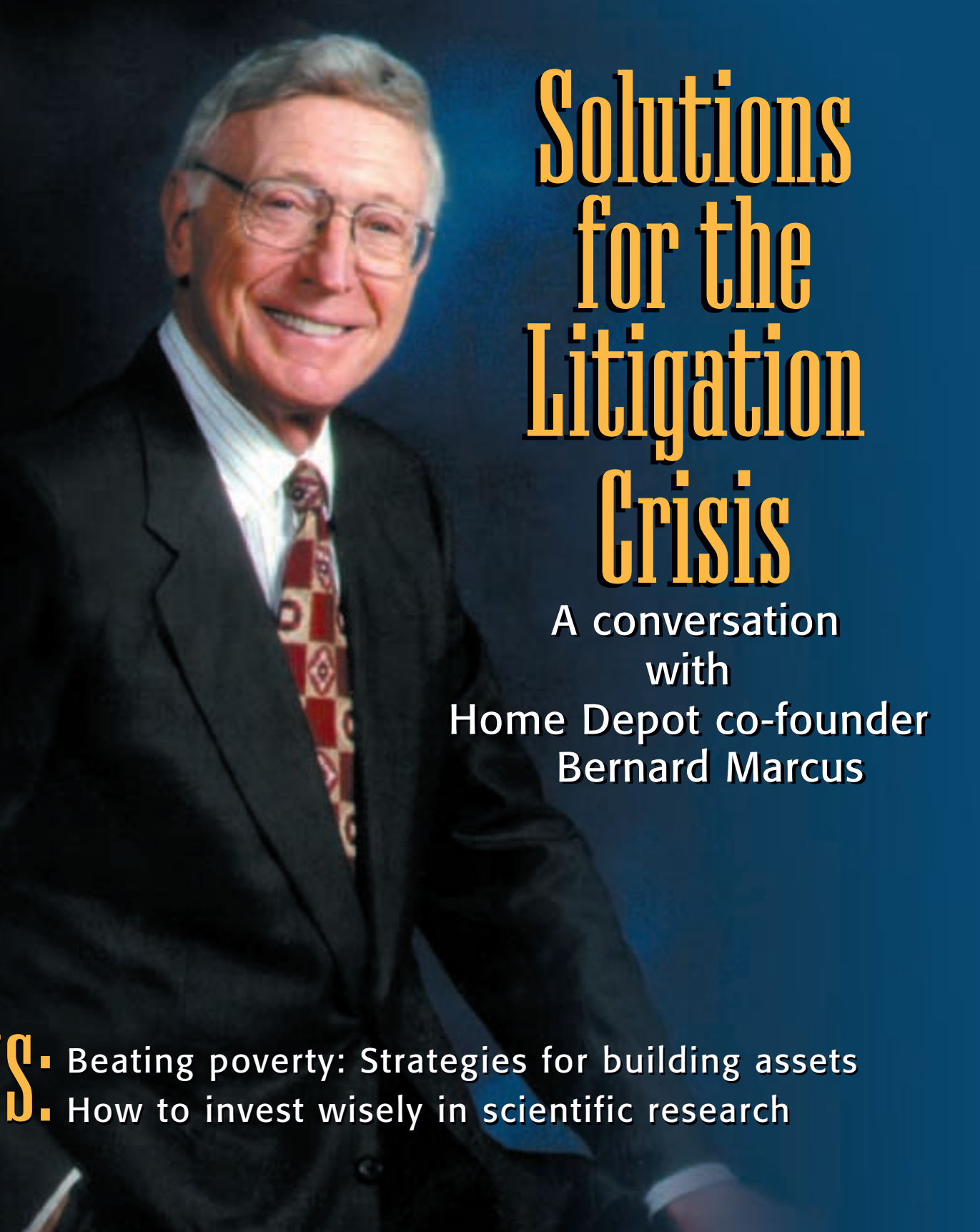


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A portrait of Bernard Marcus, co-founder of Home Depot, smiling and wearing glasses, a dark suit, a white shirt, and a patterned tie. The background is a solid blue color.

Solutions for the Litigation Crisis

A conversation
with
Home Depot co-founder
Bernard Marcus

PLUS. Beating poverty: Strategies for building assets
How to invest wisely in scientific research

Solutions for the Litigation Crisis

An Interview with Home Depot Co-founder Bernard Marcus

Bernard Marcus thinks big. As co-founder of Home Depot with Arthur Blank, he helped invent “big box” retailing. The chain, from which both men are now retired, began after the two were fired from Handy Dan Improvement Centers. In 1978 they filled “a space the size of a football field with hardware (and a few hundred empty boxes),” and by 1999 were writing their memoir, *Built from Scratch: How a Couple of Regular Guys Grew the Home Depot from Nothing to \$30 billion*.

Now Marcus is bringing the same daring and energy to his philanthropy. He handpicks recipients of grants from the Marcus Foundation, which gave away over \$20 million in the most recent year with figures available (2002). So far he’s kept the foundation’s assets low—only a bit over \$3 million that year. The primary recipients work in the areas of medicine, Judaism, free enterprise, and children, and Marcus is known both for his willingness to help grantees raise other funds and also for his unwillingness to give to anything he hasn’t researched in detail himself.

As he told one reporter, “a foundation to me is a very personal thing”—which explains his wish to give away most of his money during his lifetime. Should the worst happen, he’s prepared a video in which he details his donor intent for his trustees. He has also documented what he’s supported and “what I don’t want them to give money to.” He knows how often, “after the entrepreneur [donor] is gone, most of these foundations trash the things that started them.”

Marcus never gives without checking on a grantee’s financial soundness and urges nonprofits to operate in businesslike ways. Recently he’s joined a crusade to allow businesses, for-profit and charitable, to operate with less hindrance from unreasonable lawsuits. He spoke with *Philanthropy* about this problem and its impact on giving. (For more of Marcus’s views, hear him speak at this year’s annual meeting of *The Philanthropy Roundtable*.)



PHILANTHROPY: You’ve been retired from The Home Depot for several years and are engaged full-time in philanthropic causes such as programs for children with disorders of the brain, research on traumatic spinal cord and brain injuries, and funding a state-of-the-art emergency response center at the Centers for Disease Control to handle bioterror emergencies. Why have you taken an interest in legal reform?

MARCUS: I wish I didn’t need to be interested in legal reform. If the legal system were working the way it should, I would be able to devote much more of my energy to other philanthropic causes. But the fact is, our legal system is in such a mess that it is having a very negative impact on both the economy and our ability to help people through philanthropic and charitable organizations. We truly are in the midst of a crisis.

PHILANTHROPY: The link between legal system abuses and charitable giving and participation is probably not clear to a lot of Americans.

MARCUS: You’re exactly right. It’s easy to see business and charity as two separate spheres, and forget that abuses of the legal system have a negative impact on both. The first thing to remember is that charities, nonprofits, and foundations are every bit as much in the legal crosshairs as businesses. As a result, volunteers for nonprofits are harder to recruit because of their fear of being sued. It can be difficult to get people to serve on boards because they fear, with reason, that they might get dragged into a lawsuit. Remember, we’re living in an era when Little League umpires are sued by parents for calling junior “out” at home plate. It all adds up to a soaring liability problem that, for many organizations, has been ruinous. Without a doubt, skyrocketing litigation-related costs have come at the expense of programs that should be helping needy and needful Americans.

PHILANTHROPY: And because businesses face the same pressures, they have less money to contribute to worthy causes?

MARCUS: Yes. I hope more Americans start to realize this. Jack Welch has probably made the point better than anyone: If companies aren't making profits, or if they have to spend a lot of money on legal expenses, they have less to give back to the community. So do their shareholders. So do their workers. When companies are doing well, the community does well. During Jack's reign at GE, for instance, GE engineers volunteered to raise the standards of a Cincinnati school, a school that once sent 5 percent of its students to college and now sends 60 percent on to higher education. That's an incredible improvement! That's the way business involvement in the community is supposed to work. But the sad fact is that I couldn't have started the Home Depot in the current legal climate. That means many thousands of Americans would not have had the jobs we provided, or been able to help others in their communities. And we would not have been able to donate the many millions of dollars we have to charities.

PHILANTHROPY: What impact do lawsuits have on our overall economy?

MARCUS: Let me use a metaphor here. When I read news stories about the possibility of an asteroid hitting the earth, I think that our legal system has already been hit by an asteroid called the litigation explosion. We have by far the most expensive tort system in the world—over \$233 billion a year—or 2.23 percent of GDP. The average American family of four pays a hidden “tort tax” of more than \$3,200 a year—or \$809 a person, according to insurance consultancy Tillinghast-Towers Perrin. The U.S. Chamber's Institute for Legal Reform reports that in 2002 more than 16.3 million lawsuits were filed in state courts. That's one every two seconds, which is a national scandal and diverts enormous time and resources away from productive endeavors. You see the damage across the board—in lost jobs, slower growth, and increased bankruptcies.

The asbestos nightmare is the perfect example. Obviously, we want anyone who has suffered because of another's misconduct to get his due in court. But asbestos litigation has gone far beyond taking care of the deserving—in fact, the lawsuits clogging courts on the issue have made it far harder for the genuinely ill to get justice—and has put scores of companies out of business. I saw a figure recently that shocked even me. The cost of asbestos litigation for insurers and defendant corporations could reach an

One Funder's Practical Response to a Lawsuit Crisis

In some states, lawsuits against doctors have raised the cost of malpractice insurance so dramatically that insurance companies either refuse to insure doctors at all or set rates so high that many doctors abandon their practices. One foundation has, with the IRS's blessing, launched an ingenious stop-gap measure to slow the loss of medical services in the state it serves.

We know this thanks to an IRS “private letter ruling” that gave the foundation's project the greenlight (PLR 200347017). Private letter rulings advise individual foundations whether a particular course of action will meet with IRS approval; to help guide other foundations, the IRS makes the letters public, with the parties' names deleted.

In this case, an entity we'll call the Health Foundation was founded in 1975 to strengthen health care in an eight-county area of its state. Recently, its board realized that rising insurance costs were forcing physicians in the state to retire or move elsewhere, and discouraging young physicians from opening new practices. Even doctors willing to pay the high cost of insurance had difficulties finding coverage. The situation was particularly severe in the southeastern portion of the state and in such high-risk fields as neurosurgery and obstetrics/gynecology.

To address these problems, the foundation's board decided to create a reinsurance company that could lower risks for existing insurance companies, who could then lower the premiums they charged for malpractice insurance in the state. Because state law forbade creating a non-profit insurance corporation, the foundation formed

“Reinsurance Company” as a for-profit corporation, with the foundation as its sole shareholder. Reinsurance Company has a separate set of officers and board of directors, it files its own tax return, and the Health Foundation only controls a minority of the company's board.

The IRS ruled that these arrangements legitimately advanced the foundation's charitable purpose of promoting the community's health, that a grant to Reinsurance Company will not be an act of self-dealing, and that the grant will count toward the Health Foundation's minimum 5 percent payout. The IRS also ruled that the grant would be treated as a program-related investment because it is being made for a charitable purpose and is not expected to result in a profit to the foundation.

Warning: Circumstances matter. The IRS explicitly cautioned that this ruling was based on the unique malpractice insurance crisis in the state. If circumstances change and doctors there no longer have difficulty obtaining affordable malpractice insurance, the foundation will have to end its grants to Reinsurance Company. Also, remember that a private letter ruling for one foundation does not bind the IRS in other cases; any foundation considering a similar project should seek its own ruling.

—Jerry J. McCoy
(mccoylelaw@aol.com)

*is an independent attorney in Washington, D.C.,
specializing in charitable tax planning
and foundations.*

BERNARD MARCUS

astounding \$200 billion! This is more than the Northridge, California earthquake, Hurricane Andrew, and the September 11 terrorist attacks combined. So maybe my asteroid metaphor is not quite big enough to cover this crisis.

PHILANTHROPY: Has the medical profession been affected?

MARCUS: This is probably the most frightening aspect of the crisis. We're talking about people's lives, after all. What is especially troubling about this aspect of the crisis is that the damage is, in a sense, invisible. By that I mean that many promising medical technologies are kept from use in hospitals because of the need to avoid potentially ruinous lawsuits. These technologies could be saving lives, but they simply aren't available. We're also seeing doctors leave the profession because of litigation fears. Delivering babies, for example, is an increasingly litigious practice. According to Jury Verdict Research, Inc., the median jury award increased 43 percent from 1999 to 2000. More than half of all medical malpractice jury awards today top \$1 million, and the average jury award has increased to \$3.5 million. So it's no surprise that more than 4 out of 10 doctors have considered ending their practices.

PHILANTHROPY: Do you think Americans realize this?

MARCUS: If they did, they wouldn't put up with it. I recently read about a report by the Department of Health and Human Services that needs to become more widely known, because it puts the crisis in a perspective everyone

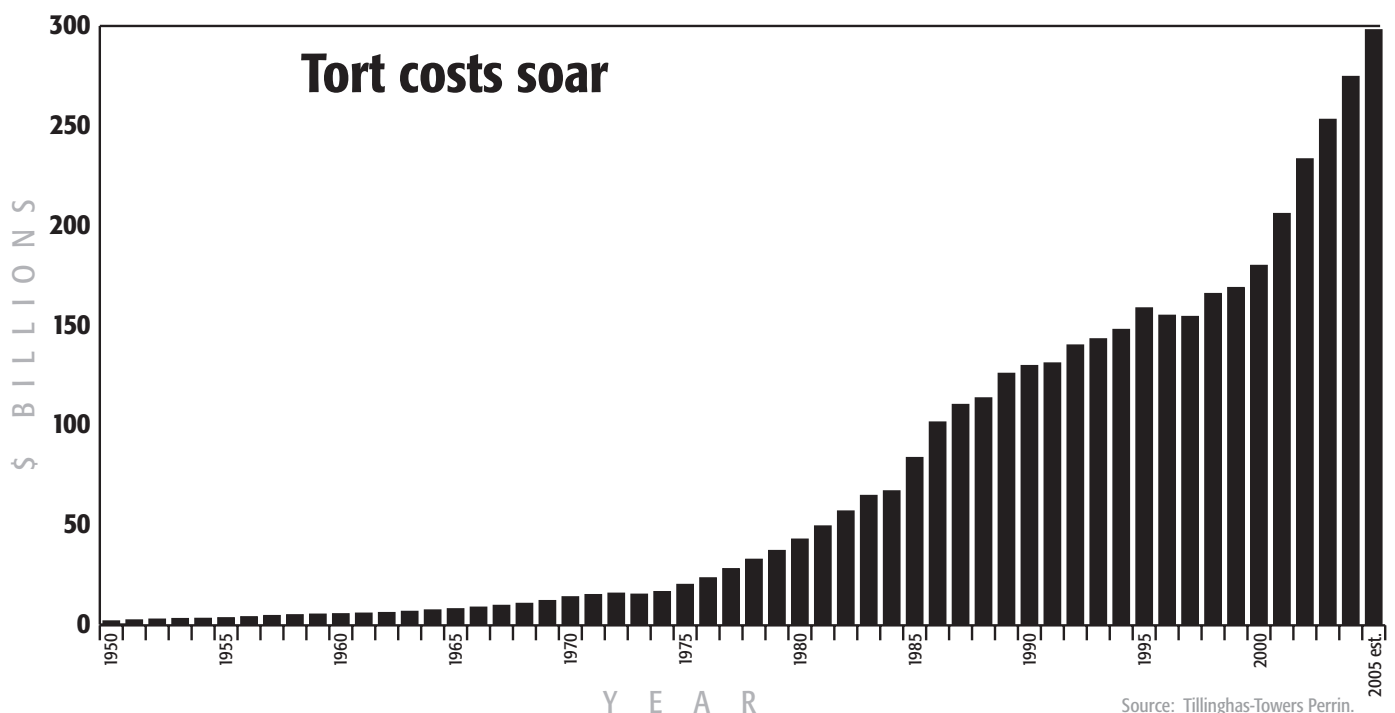
can understand. Simply by placing reasonable limits on non-economic damages in medical liability cases, the savings to taxpayers would be upwards of \$44 billion per year—enough to fund a prescription drug benefit for Medicare beneficiaries and help uninsured Americans obtain coverage through a refundable health credit, with some money left over.

PHILANTHROPY: The trial lawyers argue that product liability lawsuits make products safer.

MARCUS: They have said this, but they are wrong. Harvard Law School's Kip Viscusi investigated the impact punitive damages have on safety and discovered something very interesting: punitive damages are awarded so randomly and in such wildly varying amounts that there is no linkage between a firm's conduct and expected damages. Punitive damage awards simply don't have a deterrent effect because of the lack of predictability. Only one group in society benefits from an unpredictable legal system: trial lawyers. They benefit because unpredictability increases their leverage in settlements well beyond what a case is truly worth.

PHILANTHROPY: What activities are you undertaking to promote legal reform?

MARCUS: I think one of the most important things CEOs and philanthropic foundations can do is educate the public, media, and government officials about the extent of the legal crisis. People already have a lot on their minds, but they need to know how much this crisis is costing them, not



only in the hidden tort tax but in terms of a lower quality of life and reduced opportunities. They need to know that hopeful medical technologies aren't being advanced and that doctors are bailing out. They need to know that the legal system is wildly out of balance. Americans see high profile settlements and know something is wrong, but they aren't aware of how pervasively the crisis hurts everyone, including their families. I have no doubt that we can meet this crisis, but I know we will not get lasting reform until the public demands that their government officials support legal reform.

Another thing the public needs to understand is the amount of money trial lawyers spend on political campaigns. One of their PACs alone funneled nearly \$3 million into federal elections in 2002—making them the third largest donor. Millions more come from individual lawyers and their firms. Since 1990, the litigation industry has dumped more than \$470 million into federal campaigns. They're doing that for one reason: to influence government officials to withhold support for legal reform and thus guarantee a continuing opportunity to make huge fees by exploiting the legal system as it is set up now. So far, it has been working.

PHILANTHROPY: What reforms would you like to see?

MARCUS: Clearly, we need a reasonable limit on jury awards. But we also need to press forward on other fronts. It's simply unbelievable to me that in more than half the states juries are not allowed to hear that an injured plaintiff failed to wear a seatbelt. The fact that a driver at fault drove through a red light is not admissible in many courts. When you tell ordinary people that, they can't believe it either. How could this be, they wonder. Americans believe in personal responsibility. They need to know that the trial lawyers have made personal responsibility all but irrelevant in the courtroom—and that their \$470 million political contributions have played a crucial role in preventing reform.

PHILANTHROPY: Is this a partisan issue?

MARCUS: Well, about 90 cents out of every \$1 in trial lawyer contributions goes to Democrats. But this really should be a non-partisan issue because lawsuit abuse hurts everyone. When a life-saving piece of medical technology is held back, we all suffer, no matter what our party affiliation. And we all pay the tort tax. This is another part of the public education imperative. Philanthropic foundations, which by law cannot get involved in partisan politics, can play an important role supporting organizations that educate the public about lawsuit abuse and appropriate measures to stop it.

PHILANTHROPY: Has our culture been changed?

MARCUS: It has been changed dramatically. Steve Hantler writes in *The Seven Myths of Highly Effective Plaintiff's Lawyers*: "That our culture has changed is undeniable. Neighbors have an argument, years ago they would have

worked it out over the backyard fence. What do they do now? The New American Way—they sue. Someone likes McDonald's food too much. What do they do? They sue.

It's easy to see business and charity as two separate spheres and forget that legal abuses have a negative impact on both. Charities, non-profits, and foundations are every bit as much in the legal crosshairs as businesses.

Parents are upset over an umpire's call. What do they do? They sue." We really have become a "litigate first" culture. The lawsuit has become the option of first resort. There are more lawyers in Los Angeles county than all of Japan. Shakespeare is famous for his line about doing in all the lawyers. I don't agree. But through legal reform we can help many of them find more productive activities in another line of work. P

Changing the terms of debate

Funders who hope to shape a public policy debate face daunting challenges, but they can learn much from the history of two foundations that, as friends and foes admit, have been highly effective in changing the terms of policy debates. John Miller tells the inspiring story of the John M. Olin Foundation and the Lynde and Harry Bradley Foundation in *Strategic Investment in*

Ideas: How Two Foundations Reshaped America. Free copies are available for donors; contact us at 202.822.8333 or main@PhilanthropyRoundtable.org.

