

PART THREE - DETAILED DISCUSSION OF CERTAIN TNC PROGRAMS & ACTIVITIES

I. Related Party Transactions

a. Overview

TNC entered into a number of arrangements with “insiders” or persons who had some sort of affiliation or relationship with TNC. These transactions included arrangements with TNC Board members, affiliates of TNC Board members, trustees or officials of TNC state or local chapters, officers and employees, and in limited cases, persons considered by TNC to be independent contractors.

The Committee’s focus with respect to these arrangements was on the process undertaken by TNC, including any relevant internal policies or procedures, to ensure that the arrangement was fair and reasonable to TNC, and consistent with TNC’s status as a tax-exempt public charity. There is no explicit Federal tax law requirement regarding an exempt organization’s conflicts of interest policies. As described below, however, the existence or absence of a conflict of interest is relevant to determining whether the organization may rely on the rebuttable presumption that a transaction is not an excess benefit transaction if certain procedural requirements are satisfied. In addition, conflicts of interest procedures help promote transparency with respect to transactions with insiders.

The Staff did not attempt to determine whether the actual consideration given or received by TNC and the relevant parties in these arrangements was fair and reasonable under the circumstances, or whether any of these arrangements constituted an excess benefit transaction subject to intermediate sanctions,¹ violated the prohibition against private inurement,² or conferred upon private persons an impermissible private benefit.³ In certain instances, the Staff does make some observations about the potential application of such provisions to TNC’s transactions.

The transactions described below between TNC and its board members, or between TNC and affiliates of its board members, are all reported on TNC’s Forms 990 for its fiscal years 1992 through 2002. In response to a question from the Staff, TNC stated that “[t]o the best of our knowledge, all transactions involving a corporation with an executive serving on The Nature Conservancy’s Board of Governors at the time of the transaction are set forth in the Conservancy’s 990s, previously supplied to the Committee.”⁴ The Committee did not separately attempt to identify whether there were other insider transactions that TNC should have reported on the Form 990.

¹ Sec. 4958.

² Sec. 501(c)(3).

³ Treas. Reg. sec. 1.501(c)(3)-1(d).

⁴ TNC Narrative Response dated April 23, 2004, *see* Appendix K.

The Committee asked TNC to “[p]lease provide a list of lawyers, accountants, and other outside counsel who have provided tax opinions or other tax advice (including opinions or advice regarding compliance with relevant conflicts of interest requirements) to TNC with respect to the consequences to TNC or other parties regarding transactions between TNC and its board members, trustees, officers, executives or local chapter officials.” TNC responded that “[t]o the best of our knowledge, there are none.”⁵

TNC reported 53 transactions or arrangements between TNC and its Board members (or affiliates of its Board members) on its Forms 990 for 1992 through 2002. The following table lists the number of items reported by TNC for such years.⁶

**Table 7, Summary of Transactions with Board Members
Fiscal years 1993 through 2003**

Form 990 Year	Number of Transactions with Board Members	Number of Transactions with Affiliates of Board Members	Total items reported on Form 990 for the year
1992	1	2	3
1993	1	5	6
1994	0	1	1
1995	0	3	3
1996	0	6	6
1997	1	2	3
1998	0	8	8
1999	0	6	6
2000	1	7	8
2001	0	6	6
2002	0	3	3
Totals	4	49	53

Several of these items are described below.

b. Transactions with TNC Board members

The Appendix K contains copies of the relevant schedules from TNC’s Forms 990 for its fiscal years 1993 through 2003. During these periods, TNC reported four transactions with its Board members.

Two of these items involved free office space or services provided to TNC during the 1993 reporting period. A third item involved a land transaction in which TNC acquired property

⁵ TNC Narrative Response dated April 23, 2004, *see* Appendix K.

⁶ The Staff listed certain of these items that relate to multiple years (e.g., General Motors Corporation contribution agreement reported in each of 1993 through 2001), so the actual number of transactions involved in these reported items is less than 53.

from one of its Board members during the 1997 reporting period. TNC described that transaction as follows: “Ms. Janss entered into an option agreement with The Nature Conservancy to sell property to the Conservancy for the original purchase price. On March 13, 1998, The Nature Conservancy exercised the option and purchased the property. Janss recused herself from participating in and voting upon said transactions.” The fourth item involved a consulting fee provided to a Board member during the 2000 reporting period for attendance at a conservation seminar.

The description of the March 13, 1998, land transaction between Janss and TNC does not provide the terms of the option agreement or purchase agreement, describe the property to be acquired (real or personal, tangible or intangible), explain what is meant by “the original purchase price,” or state whether the transaction was consummated on terms that were fair and reasonable to TNC.

c. Transactions with affiliates of TNC Board members

Appendix K contains a copy of the relevant schedules from TNC’s Forms 990 for its fiscal years 1993 through 2003. During these periods, TNC reported 49 items with affiliates of its Board members.

Appendix K also contains a copy of information provided by TNC to the Committee in response to a request regarding TNC transactions with three companies of which company officers were members of TNC’s Board of Governors or Leadership Council: Georgia Pacific Corporation, International Paper Company, and Orvis Services Company. It appears that one of the transactions included in the supplemental information should also have been disclosed in the Form 990 (1999).⁷

The following is a discussion of certain of these transactions that the Staff reviewed.

1. General Motors Corporation support agreements

In its Forms 990 for 1992 through 2002, TNC reported that it had entered into transactions with General Motors Corporation (GM) pursuant to which GM agreed to support TNC with contributions of various items, including cash, vehicles, potential gifts of land, data systems equipment, and other assets of value. In each case, TNC reported that the GM officer who was also a TNC Board member (i.e., Mr. Smale from 1993 through 1997, Mr. Smith from 1998 through 2002) recused himself from participating in and voting upon the transactions.

TNC’s Form 990 disclosures of these transactions did not report the terms of these arrangements, such as value of property contributed by GM to TNC during the reporting period or over the life of the arrangement, or whether any consideration flowed from TNC to GM under these arrangements.

2. General Motors Corporation emissions arrangement

⁷ TNC Narrative Response dated April 23, 2004, *see* Appendix K (acquisition of 1807.70 acres from Georgia Pacific Company for \$406,732 on September 27, 1999).

In its Forms 990 for 1999 through 2002, TNC reported the following with respect to this arrangement: “General Motors signed an agreement with TNC to undertake a climate change project under which TNC received \$10 million and General Motors may potentially receive greenhouse gas mitigation offsets. Mr. Smith did not participate or vote on said transactions.”

The materials provided by TNC to the Committee in April 2004 contain an April 28, 2000 document that lists the names of TNC Executive Committee, Conservation Committee, and International Committee members that approved the project. The document states that the project was “approved on 4/25/00 through a fax ballot to the Executive Committee and the Conservation Committee ...”⁸ The document lists John F. Smith, Jr., as approving the project on April 26, 2000, as a member of TNC’s Conservation Committee. Mr. Smith signed the Comprehensive Agreement for General Motors Corporation and for General Motors do Brasil. Mr. W. William Weeks signed the agreement for TNC.⁹

TNC did not seek a review of this transaction by outside counsel. TNC did not obtain an independent determination that this transaction was fair and reasonable to TNC or an appraisal of the potential value of the emissions credits that could inure to the benefit of TNC.

In its submission to the Committee dated December 22, 2004, TNC provided an additional narrative response (provided in Appendix H) and additional transactional materials relating to this particular arrangement, as well as two other similar emissions credit arrangements with other investors.

3. Trademark, mailing list, name, and logo arrangements

S.C. Johnson Company transactions

In its 1995 Form 990, TNC reported that it had entered into a one-year contract with S.C. Johnson Wax which permitted it to use TNC’s trademark in a national product promotion in exchange for \$100,000. In its 1996 return, TNC reported that the contract was extended for one year, and two additional royalty streams were added (royalties paid on behalf of participating retailers, and royalties generated by customers buying a self-liquidating premium). The reports stated that Mr. Johnson recused himself from participating in and voting upon the transactions.

Procter & Gamble/Millstone Coffee transactions

In its 1996 and 1997 Forms 990, TNC reported that Millstone Coffee, Incorporated, a company owned and controlled by Procter & Gamble, entered into a five-year agreement with TNC on January 10, 1997, granting Millstone the rights to use TNC trademarks on licensed product packaging, advertisements, point-of-purchase displays, and other material. The license was “exclusive for whole bean coffee.” Under the agreement, Millstone “will pay the

⁸ FAX BALLOT FOR BRAZIL ATLANTIC RAINFOREST REFORESTATION PROJECT, BRAZIL from Mike Dennis to Jonathon Rotter, Steve Cox, and Joe Keenan, dated April 28, 2000, *see* Appendix Q.

⁹ TNC stated in discussions with Staff on June 1, 2005, that the Conservation Board did not have the responsibility for approval of the said transaction. TNC stated the Conservation Board had an advisory role.

Conservancy royalties of a minimum of \$400,000 over five years plus two percent of net sales of licensed product.” The licensed product consisted of Organic, Estate, and Limited Edition coffees. In its 1998, 1999, and 2000 Forms 990, TNC modified the definition of licensed product to refer to “Millstone Exotics brand Organic Mayan/Black Onyx and Organic Aztec Star & Sky coffees.”

Discovery Communications transaction

TNC reported in its 1997 and 1998 Forms 990 that Discovery Communications had entered into a licensing transaction with TNC. The description stated that “[e]ffective September 17, 1997, in cooperation with the National Audubon Society, The Nature Conservancy licensed its name and logo to Discovery Communications for use in connection with the “All Bird Television” series. The non-profits also provided funding for the series and performed editorial consulting services. In return, they received royalty rights, rights to use the original footage from the series, rights to purchase home video copies of the series at cost, and credits at the opening and end titles of every broadcast.” The descriptions did not state the terms of the agreement.

TNC reported in its 1997 and 1998 Forms 990 that TNC “granted Discovery Communications permission to use its name to promote the Discovery Channel credit card. In return, the Conservancy receives revenues generated from the card.” The description did not state the terms of the agreement.

The reports stated that Mr. Hendricks, the Discovery Communications officer, did not participate in said transactions.

GM mailing list agreement

In its 1993 reporting period Form 990, TNC reported that GM entered into an agreement to rent membership mailing lists from TNC at “full fair market value.” No terms of the agreement were disclosed.

4. Cisco Systems and Morgridge transactions

In its 1998, 1999, 2000 and 2002 Forms 990, TNC reported that TNC “acquires computer upgrades and purchases from Cisco Systems, Inc., at a substantial discount. Before any orders are placed Mr. Morgridge [the TNC board member and chairman of Cisco Systems, Inc.] reviews the order and approves the discounts.” In its 2001 Form 990, TNC stated that it paid a total of \$145,477 to Cisco Systems, Inc. for the following transactions: “From July 2001 to around March/April 2002 the arrangement was: 1) CISCO gives TNC an automatic 30% off their list price[;] 2) TNC purchases its equipment DIRECTLY from CISCO[;and] 3) TNC submits to Mr. Morgridge the amount paid to CISCO[.] This resulted in an effective 76% discount from list to TNC.”

In TNC’s supplemental response to the Committee’s request for information regarding the 2001 description, TNC stated: “From July 2001 to around March/April 2002 the process to execute this arrangement was: 1) TNC submits list of desired Hardware/Software to CISCO Systems for a quote. 2) CISCO provides a quote to TNC, which includes 30% discount off list price. 3) TNC submits for approval 2/3 of the quote (Hardware/Software) to the Morgridge

Foundation for payment approval. 4) If approved: Morgridge Foundation pays 2/3 of total Hardware/Software equipment cost. TNC pays remaining 1/3 cost in Hardware/Software DIRECTLY to CISCO. 5) This resulted in an effective 76% discount from list to TNC.”

The TNC supplemental response contained an example to demonstrate the amount of the discount, and described its dealings with the Morgridge Foundation as “ask[ing] for [a] donation.”

The TNC description in the 2001 Form 990 did not refer to the Morgridge Foundation. Neither TNC’s Form 990 nor TNC’s supplemental submission provided any details regarding the Morgridge Foundation, or whether the Morgridge Foundation had any affiliation or relationship with Mr. Morgridge or Cisco Systems, Inc.

In its submission to the Committee dated December 22, 2004, TNC provided additional information regarding this arrangement.

5. Land or Easement Deals

Mitchell ranch transaction

In its 1993 Form 990, TNC reported that a member of TNC’s Board sold a majority of his ranch to his ranch manager, who in turn sold 1,000 acres to TNC, and gave TNC a conservation easement on 1,800 acres. No other terms of the transaction were described.

FM Properties transaction

In its 1993 Form 990, TNC reported that it sold 4,282 acres to a partnership that was related to a corporation of which one of TNC’s Board members was also a board member. The TNC sale was reported to be “[s]ubject to the legal condition that 4,070 acres were donated back to [TNC] for conservation.” The Board member recused himself from any involvement in this project. No other terms of the transaction, or explanation for the sale-contribution form of the transaction, were provided in the description.

Georgia Pacific transactions

TNC entered into several land transactions with Georgia Pacific or affiliates of the company. The Chairman of the Board and Chief Executive Officer of Georgia Pacific Corporation was a TNC Board member. In its 1996 Form 990, TNC reported that it acquired 1,000 acres of land in Wisconsin from a Georgia Pacific subsidiary for the fair market value price of \$575,000. In its 1998 Form 990, TNC reported that it acquired 1,108 acres in Maine from another affiliate for consideration of \$380,000. In its 1999 and 2000 Forms 990, TNC reported that it purchased 9,477 acres of land in Louisiana from another subsidiary of the company for \$7.5 million, with the closings taking place over two years. Also in the 1999 Form 990, TNC reported that it bought 5,482 acres known as Van Swamp in North Carolina from a subsidiary of Georgia Pacific. No purchase price was reported for the acquisition of the North Carolina property.

TNC noted that in each case, the Board member recused himself from participating in and voting upon the transaction.

Quentin transaction

In its 1996 Form 990, TNC reported that in a partial sale, TNC acquired property on September 23, 1996, and February 19, 1997, in the amounts of \$279,851 and \$359,350, respectively. An unsecured promissory note dated February 19, 1997, was entered into and was payable September 12, 1997. No other terms of the transactions were disclosed. The owner of the corporation that sold the properties to TNC was also a TNC Board member. The Board member recused himself from participating in and voting upon the transactions.

Orvis transaction

In its 1998 Form 990, TNC reported that it acquired a conservation easement covering approximately 1,622.48 acres in Florida from Orvis Services, Inc., for consideration of \$648,992. The President and Chief Executive Officer of Orvis Company, Inc., an affiliate of the easement grantor, was a TNC Board member. TNC noted that the Board member recused himself from participating in and voting upon the transaction.

SMI easement deal

In its 2000 Form 990, TNC reported that Silver Mountain Industries (SMI), a subsidiary of Leucadia National Corporation, donated a conservation easement (439.22 acres) valued at \$3,950,000 to TNC, which included a public train easement. In addition, SMI made a cash endowment of \$25,000 that was received by TNC in July 2000. A TNC Board member was chairman of Leucadia Corporation. He recused himself from participating in and voting upon the transaction.

At the request of the Committee, TNC provided supplemental information regarding this transaction. In the supplemental response, TNC described the property subject to the easement and the surrounding area.

6. Other arrangements

AOL content provider arrangement

In its 1995 Form 990, TNC stated that TNC “is a content provider on America Online, and maintains a forum that provides information on the Conservancy’s work both domestically and abroad.” The President of AOL Enterprises was a TNC Board member. TNC noted that he recused himself from participating in and voting upon said transactions. No terms of the agreement were provided in the description.

S.C. Johnson Company arrangement

In its 1998 Form 990, TNC reported that “[d]uring the fiscal year commencing on July 1, 1998, and terminating on June 20, 1999, S.C. Johnson & Son, Inc., paid \$100,000 to The Nature Conservancy in a promotion.” There was no indication that this was a renewal or

continuation of earlier arrangements between the two organizations involving trademark licensing. The report stated that Mr. Johnson recused himself from participating in and voting upon said transaction.

Orvis arrangement

In its 1996 Form 990, TNC reported that it entered into the following transactions with Orvis Company: “General activities on Mays Pond; and sale of fly fishing tackle to the Belize Program.” The President and Chief Executive Officer of the company was a TNC Board member. He recused himself from participating in and voting upon said transactions. No terms of the arrangement were provided in the description.

d. Transactions with TNC International Leadership Council members

TNC engaged in certain transactions with members of its International Leadership Council (“ILC”). The ILC serves as an advisory committee that makes recommendations to the board of governors and is therefore not a governing body with decision making authority. Because TNC did not report any of these transactions on its Form 990, the Committee requested information regarding the council and certain of these transactions.

TNC describes the council as a corporate “giving club” created in 1995, with each company on the council contributing \$25,000 per year to TNC.¹⁰ TNC facilitates a meeting for the council supporters approximately every nine months, with attendees responsible for covering their own travel and hotel expenses. There are no formal committees or subcommittees. TNC stated the council has no governance function within TNC.

The submitted materials list nine separate land acquisition transactions with reported values of approximately \$119 million with International Paper Company, or its affiliates, one of the companies with representation on TNC’s Leadership Council. In these transactions, International Paper Company transferred approximately 496,500 acres to TNC or other grantees. TNC has transferred many of these properties to others in conservation transactions. In a tenth transaction, the company acquired from TNC certain timber rights on 140 acres for \$44,104.

e. Transactions with individuals or affiliates who subsequently became TNC Board members

TNC engaged in at least one transaction with individuals, or companies associated or affiliated with individuals, who became a TNC Board member after the transaction was completed. Presumably because the Board relationship did not exist at the time the agreement was completed, TNC did not report this transaction on the Form 990. This transaction was an emissions credit arrangement with AEP, which is discussed in Part Two of the report.

f. Transactions with TNC State or Local Chapter Trustees

¹⁰ According to TNC’s submission, contributions from the council members totaled approximately \$700,000 per year for each of fiscal years 2001 through 2003.

TNC entered into numerous CBP, trade lands, and easement transactions with trustees or officials of its State and local chapters. TNC did not report any of these transactions on its Form 990, presumably because these trustees do not perform governance functions.

g. Employee Loans

TNC entered into several employee loan transactions that were reported on the Form 990. Two of these transactions are described below.

1. Loan to Steve McCormick

By resolution of the Board of Governors of TNC on December 20, 2000, Steven J. McCormick was elected as President and CEO of TNC, effective February 1, 2001, and was also elected to TNC's Board of Governors as of the same date.

TNC made a loan to Steve McCormick, the President and CEO and a member of the Board of Governors of TNC, on May 22, 2002, in the amount of \$1,550,000.¹¹ The loan was for a term of ten years and interest was charged at the rate of 4.59 percent per annum. The note converted to a demand note should Steven McCormick no longer be employed by TNC. The interest rate is adjustable each year on May 1. The interest rate was indexed to the weekly yield on United States Securities adjusted to a constant maturity of one year, as made available by the Federal Reserve. The rate was further adjusted by the addition of 200 basis points to the indexed rate. The interest rate was capped at 8 percent over the life of the loan. The floor for the interest rate was 4.59 percent. The loan provided an interest -- only payment which was payable monthly. The loan was payable by both Steven J. McCormick and his wife named in the Note. The loan was secured by a deed of trust on the property. The property serving as security for payment of the loan was stated to have a value of \$1,725,000.

The Staff notes it is difficult to compare the interest rate charged on the loan and the other terms of the loan to the going rate (and terms) for mortgages in the Washington, D.C. area for the same time period, May 2002. A report provided by HSH Associates, Financial Publishers of Pompton Plains, New Jersey provides a chart of "average" interest rates for "jumbo" loans. The HSH chart for the date May 24, 2002, for Washington, D.C. for a jumbo loan indicates that the average rate is 4.91 and the average points are 0.92. Since the payment of points tends to lower the interest rate, a loan with no points (as was the case for the McCormick loan) suggests that the rate for such a loan should be greater than 4.91 percent.¹²

A Freddie Mac Survey indicated that the average rates for a one-year adjustable rate mortgage for May 23, 2002, was 4.85 percent and the average points was 0.7. There is no indication that this rate applied to a conforming or jumbo loan. It is unclear whether this rate

¹¹ TNC Narrative Response dated July 25, 2003, *see* Appendix D.

¹² TNC stated to Staff on June 1, 2005 that they used rates available on May 3, 2002, *see* Appendix K for TNC's memo regarding the loan to McCormick.

applied to loans with a 10-year repayment period. Interest rates for jumbo loans tend to be higher than rates for conforming loans.

McCormick paid off the loan to TNC by a certificate of satisfaction filed with the local court on May 8, 2003 shortly after *The Washington Post* published its series on TNC.

If the TNC – McCormick loan offered significantly better terms (interest only payments, better lifetime cap, favorable index for adjustment of interest rate and a better interest rate than the commercial or arms length mortgages offered at the time), the loan had value and may have provided an economic benefit to Mr. McCormick within the meaning of section 4958. An excess benefit transaction under section 4958(c)(1)(A) of the Code provides that an economic benefit shall not be treated as consideration for the performance of services unless the organization clearly indicated its intent to so treat such benefit.

The Committee requested that TNC provide additional information regarding the McCormick loan. In response to this request, TNC stated that treasury regulation section 53.4958-4T(c) did not apply to the loan transaction between TNC and Mr. McCormick because the loan was not intended to compensate him for his services and TNC charged Mr. McCormick an arm's length interest rate.¹³

Section 53.4958-4T(c)(3)(iii) of the regulations provides that if an applicable tax-exempt organization's failure to report an economic benefit as required is due to reasonable cause (within the meaning of section 301.6724-1), then the organization will be treated as having clearly indicated its intent to provide an economic benefit as compensation for services. See also Example (2) of section 53.4958-4T(c)(4) of the regulations. TNC, in its response of April 5, 2004, did not state that a reasonable cause exception pursuant to section 53.4958-4T(c)(3)(iii) was applicable to the loan TNC made to Mr. McCormick.

TNC also stated that it met the "approved in advance" requirement of section 53.4958-6T(a)(1) of the regulations regarding the rebuttal presumption for the overall compensation of Mr. McCormick.¹⁴ TNC states that:

Each year, the Conservancy's Board of Governors sets compensation for President/CEO at its January meeting. Their decision is effective retrospectively to the first day of the month. Under this process, the President/CEO is paid based on the prior year's salary for the first pay period in January. However, if the Board of Governors votes a pay increase for the President/CEO, the Conservancy includes a retroactive adjustment in his paycheck for the second half of January that corrects the underpayment for the first pay period. In this way, the President/CEO receives compensation at a single rate for the entire calendar year.

¹³ TNC Narrative Response dated April 5, 2004, *see* Appendix J.

¹⁴ *Id.*

TNC's Board of Governors held a meeting on January 29, 2002 which included setting Mr. McCormick's compensation for 2002. His salary was increased by \$25,000 to \$300,000. He received immediately a payment of \$25,000 as incentive compensation for services provided in year 2001.

2. Shared Appreciation Note with Dr. Graham Chisolm

During January, 2001, a shared appreciation note was negotiated between TNC and Dr. Graham Chisolm to compensate him for the differences in the housing costs between Reno and San Francisco, when he agreed to accept the position of Executive Director of TNC of California and relocate to San Francisco. The note was intended to offer Dr. Chisolm limited financial assistance to find a residence in San Francisco that was reasonably comparable to the residence he left in Nevada.

TNC states that Dr. Chisolm was not a disqualified person with respect to TNC at the time he negotiated the note with TNC pursuant to the authority provided under section 53.4958-4T(a)(3) or the regulations.¹⁵ Section 53.4958-4T(a)(3) of the regulations provides that section 4958 does not apply to any fixed payment made to a person pursuant to an initial contract. A fixed payment is defined in section 53.4958-4T(a)(3)(ii) as an amount of cash or other property specified in the contract, or determined by a fixed formula specified in the contract, which is to be paid or transferred in exchange for the provision of specified services or property. Section 53.4958-4T(a)(3)(iii) defines the term initial contract as a binding written contract between an applicable tax exempt organization and a person who was not a disqualified person within the meaning of section 4958(f)(1) immediately prior to entering into the contract.

Section 53.4958-4T(a)(3)(vii), example 10, provides an example of a person who entered into an initial employment contract which included the right to borrow funds from the section 501(c)(3) employing organization. The example concludes that section 4958 does not apply to the loan because of the initial contract exception.

TNC states that this regulation is directly applicable to the shared appreciation note held by TNC in which Dr. Chisolm is the obligor. TNC states that Dr. Chisolm was not a disqualified person as to TNC prior to the new position as Executive Director of TNC of California based on either of two grounds. First, Dr. Chisolm met the requirements of section 53.4958-3T(d)(3) in that his salary was less than a specified amount. Additionally, Dr Chisolm, in his prior position as State Director of the Nevada Program, was not a disqualified person under the facts and circumstances analysis of section 53.4958-3T(e) of the Regulations. TNC indicated that the note was not signed until July 9, 2001, which is approximately six months after he assumed the new position. TNC also states that the letter confirming Dr. Chisolm's appointment sets out the terms of the Note.

TNC states that in response to the controversy prompted by the articles by *The Washington Post*, TNC's Board of Governors decided it had to terminate loan situations with employees. Dr. Chisolm agreed, and paid off the loan on November 18, 2003.

¹⁵ TNC Narrative Response dated April 5, 2004, *see* Appendix J.

h. Use of Independent Contractors

The Committee requested information regarding TNC's payments to a particular individual. TNC provided various information including copies of the contracts, invoices, etc. regarding the services provided by this individual to TNC in a capacity as an independent contractor. These documents support TNC's assertion that the individual is an independent contractor and not an employee. However, TNC does not appear to have considered the individual's status as a disqualified person for purposes of testing whether payments to her constitute an excess benefits transaction. Section 53.4958-3T(d)(3) of the regulations list facts and circumstances that tend to show a person does not have substantial influence over the affairs of the organization. One of the factors of such regulation is found under subsection (3)(ii); that is section 53.4958-3T(d)(3)(ii). The regulation provides as follows:

The person is an independent contractor (such as an attorney, accountant, or investment manager or advisor) whose sole relationship to the organization is providing professional advice (without decision-making authority) with respect to transactions from which the independent contractor will not economically benefit either directly or indirectly (aside from customary fees received from the professional advice rendered).

Observations

1. Lack of transparency. TNC generally did not completely and clearly disclose and report many of these related party or insider transactions. In many cases, it is impossible to determine the nature and material terms of the transaction without looking beyond TNC's descriptions contained in its Forms 990.
2. Recusals. TNC's descriptions of its insider transactions on the Form 990 suggests that the relevant insider routinely recused himself or herself from participating in or voting on the transaction.
3. Legal or tax opinions regarding conflicts of interest or tax consequences. TNC did not seek the advice of outside counsel to determine whether such transactions were compatible with tax law or internal conflicts of interest requirements and state nonprofit laws, or to obtain a tax opinion with respect to the consequences of any of such transactions. Staff recognizes that TNC is under no obligation to seek outside guidance on the legal consequences of any transaction, but notes that in the case of highly complex, novel, or insider transactions, this may be advisable.
4. Fairness to TNC. Except in the case of certain of TNC's land transactions with insiders, it appears that TNC did not confirm that the transactions were done at terms that were fair and reasonable to TNC. TNC apparently did not regularly seek or obtain appraisals or fairness opinions with respect to these transactions.
5. International Leadership Council. TNC's Conflicts of Interest Policy extends to trustees of state and local chapters of the organization, but does not apply to members of the International Leadership Council.
6. Morgridge / Cisco. TNC's description of the Morgridge/Cisco transaction was incomplete and vague, and did not describe the role of the Morgridge Foundation in the transaction. TNC

did not refer to the Morgridge Foundation in the Form 990 disclosure of the transaction, or provide details regarding the relationship of the foundation to Mr. Morgridge or to Cisco Systems, Inc. in its supplemental response. The Staff did not determine the extent to which the foundation might be using its funds to benefit Cisco Systems, Inc.

7. GM Emissions Deal. The GM emissions arrangement is an unusual transaction that should have been more thoroughly and accurately disclosed by TNC in its Form 990 reports. Mr. Smith's role in the transaction should have been more accurately described by TNC.

8. TNC Reforms. In 2003, TNC revised its policies regarding land transactions, easements, and conservation buyer program transactions, with respect to insiders.

II. CBP Transaction – Martha's Vineyard

One of the Conservation Buyer Program transactions reported in *The Washington Post* series involved a property located on Martha's Vineyard. TNC prepared the following summary of this transaction for its June 13, 2003 Board of Governors meeting.

CONSERVATION BUYER TRANSACTION SUMMARY—E

Site or Project Name: Herring Creek Farm, Martha's Vineyard, MA

Purchaser Name:

Land: approximately 220 acres located on the southeast quadrant of the Island

Date of Sale: July 2001

1. **Consistency with Conservation by Design:** The site that contains the Herring Creek Farm tract is a portfolio site within the North Atlantic Coast Eco-region plan. The Herring Creek Farm property has been of long-standing interest to the Conservancy because of its close proximity to Katama Plains, which is currently managed by the Conservancy. Katama is an excellent example of existing sandplain grasslands. The coastal sandplain grasslands natural community found on Martha's Vineyard is one of the most threatened natural systems on Earth, with less than one percent of its original global acreage remaining. By restoring the Herring Creek farm property to the original native sandplain grasslands, the Conservancy has been working to expand this rare habitat to create a better functioning, less fragmented ecosystem. This is especially beneficial to animals that require large spaces to forage and reproduce, like the northern harrier, a species of hawk. Once restored, the grassland and beachfront habitats at Herring Creek Farm will support rare local bird species like the grasshopper sparrow and short-eared owl as well as rare native plants such as the Nantucket shadbush and bushy rockrose. The restoration of the 102 acres permanently protected from development at Herring Creek Farm will be one of the largest such projects ever undertaken in this ecosystem, will take many years to complete and is scheduled to begin in earnest within two years.
 - **Threat:** Originally proposed for 58 lots, The Herring Creek Farm property had been officially approved for a 33 lot subdivision by both the Martha's Vineyard Commission and the Town Planning Board.
 - **Conservation Easement:** The conservation transaction undertaken by TNC will further limit the property to six additional houses and assure that 102 acres of the property are in permanent conservation status. The conservation easement prohibits any Atlantic beachfront development, requires that any new homes may only be constructed on former farm pasture and/or previously cleared land and includes prohibitions on such things as outdoor lighting, and use of pesticides, herbicides and synthetic fertilizers. None of the new home development may occur on actual or potential sandplain grasslands. The Conservation Commission of Edgartown will co-hold the conservation restrictions with the Conservancy.
2. **Valuation Substantiation:** TNC obtained an independent, professional appraisal, dated as of July 17, 2001, indicating a total value of the land that was purchased at \$64M, as confirmed in meetings with TNC staff (Note: Sellers appraisal was for \$78M for the same land.)
3. **Marketing Efforts:** None
4. **Buyer's Relationship to TNC:** No party in this transaction held any official position or had any prior connection to TNC.
5. **Structure of the Deal:**
 - The Nature Conservancy purchased the entire property from its then current owners, Neil and Monte Wallace and the Wallace Family Trust for the Conservancy's appraised fair market value of \$64M.

- TNC then placed a Conservation Restriction on the entire property limiting the number, size and location of any buildings and protecting the East Fields (62 acres) and Central Fields (40 acres) and Moore Beach Parcel (20 acres.)
 - TNC retained ownership of the East and Central Fields
 - TNC then sold or exchanged:
 - 1) 15.85 acres to Fairview MV Property, LLC (Roger Bamford and Denise Lahey) for \$7.250M. and 9.62 acres remaining to be sold for \$4.750M (for a total of \$12M.), based on confirmed appraised values as of July 9, 2001.
 - 2) approximately 46 acres to the Farming Agriculture and Resource Management (F.A.R.M.) Institute, a non-profit, educational institution, for \$28M.
 - F.A.R.M. then sold approximately 39 acres of their acreage to the MV Regency Group (David Letterman) for \$27M. This sale was made subject to restrictions limiting the property to being subdivided and sold in up to three lots to private buyers. MV Regency Group retained a portion of the property, and sold one lot to James B. Denman, Trustee of Butler's Cove Realty Trust (Daniel Stanton) and one lot to Petergro Acquisition Company (David Peters.)
 - 3) Transferred certain lots to the Wallace family's predecessor in title, the Cohan family, to the land who held a right of first refusal over the property, in exchange for and in order to extinguish those rights.
 - F.A.R.M. also leased approximately 40 acres of the Conservancy's owned land for a demonstration farm and for education and research. The cost to F.A.R.M. of the lease was \$1.
 - TNC received charitable contributions of:
 - \$18.5M, in cash, from the Wallace Foundation
 - \$ a pledge of an amount in excess of \$10M from Roger Bamford to be satisfied by July, 2003.
 - **Transaction Category:** (multiple parts, exceptional case)
6. **Other Conservation Purposes Served:** to keep the Central Field in a compatible use such as agriculture, to limit the number, location and size of houses to protect the water quality at Edgartown Great Pond and to protect the nesting bird population and dune community on the Moore Beach Parcel
7. **How would possible changes in TNC conservation buyer policy have changed the transaction?** Possible restrictions to achieve community standards for residential structures; possibly a wider marketing effort.

Observations

1. In general. The transaction first described in *The Washington Post* series involving the Herring Creek Farm on Martha's Vineyard involved numerous parties, substantial transactional complexity, unusual payments by TNC (such as tax indemnity payments to cover tax obligations of another party to the transaction), and what appear to have been circular flows of millions of dollars between the Wallace family members and TNC. Although TNC ultimately obtained and held over 100 acres of said property on which conservation restrictions were placed, several components of the overall transaction warrant scrutiny to determine the appropriate tax treatment to the parties, and to assess whether TNC's participation in the overall transaction substantially furthered conservation purposes that outweighed any private benefits derived by other parties to the transaction.

2. Charitable Contribution Deductions. Based on Form 8283 filings provided to the Committee, it appears that charitable contribution deductions were claimed with respect to the transaction by various taxpayers, including the following:¹⁶

- \$2.068 million for bargain sale of real estate and certain preemptive rights to TNC by Herring Creek Acquisition Company, LLC ("HCAC")
- \$1.125 million aggregate deduction claimed by Wallace family members pertaining to the transfer of undivided interests in a Slough Cove Road parcel to TNC
- \$50,000 claimed by Wallace family members pertaining to a transfer of undivided interests in another Slough Cove Road parcel to TNC
- \$760,000 claimed by Wallace family members pertaining to a transfer of undivided interests in ocean front property to TNC
- \$12.115 million claimed by Windsor Capital Corporation with respect to the bargain sale of Herring Creek Farm by the corporation to TNC¹⁷

3. No charitable contribution deduction attributable to 170(h) conservation restrictions. In its review of the Forms 8283 related to this transaction, the Staff did not find that any party to this transaction sought a charitable contribution deduction for the grant of a conservation easement. The filings suggest, as noted above, the contribution deductions appear to have been related to the donation of undivided interests, preemptive rights and bargain sales.¹⁸ The Staff notes that

¹⁶ Each of the Forms 8283 report the date of the donation as July 20, 2001.

¹⁷ The Staff notes that this list contains certain contributions not described in TNC's above summary provided to the Board of Governors.

¹⁸ See Summary of Form 8283 and Form 8282 Filings, pp 32-34 below. For example, each 10% undivided interest of a certain property valued on the Form 8283 at \$110,000 appears to have been sold by TNC for \$62,500. The property acquired by TNC on July 20, 2001, from Windsor Capital Corporation for \$64 million, and which was appraised at \$76.115 million, was reported as sold by TNC for \$35.350 million on July 24, 2001. The Staff assumes the decrease in values reported for these properties results in part from TNC retaining certain portions of the

this is the type of transaction that may lead to the circumvention of 170(h) requirements discussed in Part Two of this report.

4. Indemnification of HCAC's Federal and state tax liabilities. In the June 29, 2001, agreement between TNC and HCAC (under which TNC transferred certain property to HCAC and TNC acquired certain preemptive rights from HCAC), TNC agreed to make a \$1.484 million tax indemnity payment to HCAC to cover certain of HCAC's taxes attributable to the transaction. Under this agreement, the amount of TNC's tax indemnity payment was to be adjusted in the event of a Federal or State income tax audit of HCAC. The documentation states that TNC also paid \$402,755 of HCAC's legal expenses, and executed a "tax-make whole" agreement with HCAC. The Staff notes that such agreements and payments raise private benefit issues.¹⁹

5. Tax treatment to HCAC and others with respect to preemptive rights. In the June 29, 2001, agreement between TNC and HCAC, the parties agreed that HCAC would claim a charitable deduction of up to \$2.066 million attributable to the bargain sale of the preemptive rights to TNC. This represented the excess of the appraised value of \$14 million for the rights over the \$11.9 million purchase price allocated by TNC to these rights. The preemptive rights acquired by TNC from HCAC in June 2001 had been transferred by the Wallaces to HCAC only a few months before in December 2000. It was not clear to the Staff why the December 2000 transfer of the rights occurred, or who owned HCAC. Further, it was not clear to the Staff why TNC was required to purchase the preemptive rights previously held by the Wallaces from HCAC, given that TNC was acquiring the property to which the rights pertained from the Wallaces or a an entity affiliated with the Wallaces. The Staff reviewed documentation that stated that preemptive rights possessed by the Cohans were to be released as part of the overall transaction, but the Staff could not determine whether the Cohans were paid, directly or indirectly (e.g., through the Wallaces), by TNC for the release of such rights. During the investigation, the Committee asked TNC to provide information regarding the ownership of HCAC and other entities involved in the transaction, as well an explanation of TNC's payments with respect to the preemptive rights, to help the Staff understand the various components of the overall transaction. TNC stated to the Committee that it did not know who owned HCAC, and provided cursory information regarding the transfer of the preemptive rights. In discussions between the Staff and TNC on June 1, 2005, regarding this transaction, TNC informed the Staff that HCAC was owned by the Aldeborghs and the Cohans, and stated that TNC was required to negotiate with HCAC in order to obtain the required consent of the Cohans to proceed with completion of the transaction. One of the Staff's substantive concerns regarding the payment by TNC of amounts designated as made for preemptive rights is that the payments be characterized by the Wallaces, HCAC, the Cohans, and any other involved parties, in accordance with applicable Federal income tax laws, and that the parties responsible for recognizing income with respect to such payments properly report such

property (the property acquired from Windsor Capital Corporation), and TNC imposing conservation restrictions on some portions of the property.

¹⁹ In discussions between TNC and the Staff on June 1, 2005, TNC stated that the TNC-HCAC indemnification agreement was part of a mutual indemnification arrangement, pursuant to which Roger Bamford agreed to indemnify TNC for amounts it paid to HCAC pursuant to TNC's indemnification obligation to HCAC. The Staff notes that private benefit issues remain regardless of whether the any Bamford indemnification rights and obligations are taken into account.

income. For example, the Staff questions whether the payment by TNC to HCAC for preemptive rights should be properly treated by the parties as a payment by TNC to the seller of the underlying real estate, and a separate payment of that same amount by the seller of the property to HCAC in exchange for the release of HCAC's rights, or instead should be treated for Federal tax purposes (as is suggested by the parties) as a direct payment by TNC to HCAC (without any intervening payment to the seller with respect to that amount). The Staff notes that the structuring and transferring of the preemptive rights immediately prior to and as part of the transaction may have been done for non-tax purposes, including with respect to disputes between various parties to the transaction, but is concerned that it may have been accomplished to achieve tax minimization objectives for the involved parties.

6. Wallace and TNC purchase agreement. The purchase price terms of the purchase agreement between the Wallace family and TNC provided considerable flexibility to the Wallaces to determine the ultimate purchase price for the property, and how much was to be treated as a contribution by the Wallaces. The Staff notes that this flexibility may have allowed the Wallaces to achieve optimal tax benefits with respect to the transaction. For example, they may have been able to structure the purchase price to optimize their capital gains and charitable contribution deduction tax planning objectives. It was also unclear to the Staff why Real Estate Equities Limited Partnership paid \$18.5 million to TNC to help fund the purchase price when the partnership appeared to be obligated to contribute only \$9.5 million under the pledge agreement.

7. TNC's involvement in tax planning. The Committee asked TNC to explain the structuring of the agreement.²⁰ TNC's response stated that it did not assist the Wallace family members or any other parties to the transactions with respect to planning their tax consequences and that, because Wallaces had the right to specify the purchase price of the land, TNC was not in a position to speculate why the particular contribution structure was selected.²¹

8. Ownership of entities and other parties to transaction. TNC stated to the Staff at various times that it had no knowledge as to the identity of owners or members of Windsor Capital Corporation, HCAC and the Real Estate Equity Limited Partnership.²² TNC also stated that Windsor Capital Corporation is the parent company of Windsor Investment Co., Inc., which, in turn, is the holder of the beneficial interest of Herring Creek Farm Trust, a nominee trust.²³ The Staff observes that a full understanding of the legal rights and obligations, and tax consequences, of the Martha's Vineyard transaction and its components may not be realized without knowledge of the owners of the various entities that participated in the transaction. On June 2, 2005, TNC informed the Staff that it had knowledge of the identity of the owners of HCAC early on in the negotiations regarding the transaction.

²⁰ Committee Letter to TNC dated October 27, 2004, *see* Appendix B.

²¹ TNC Narrative Response dated November 23, 2004, *see* Appendix M.

²² For example, TNC Narrative Response dated May 12, 2005, Appendix M.

²³ *Id.*

Overview

After the completion of a series of transactions, a property consisting of approximately 215 acres of land known as Herring Creek Farm (the “Farm”) was acquired by TNC, subdivided into various parcels, and ultimately split up to be owned in part by TNC and in part by others. A portion of the acquired property became subject to conservation restrictions enforceable by TNC and the Town of Edgartown, Massachusetts.

At the start of the transaction, TNC acquired and became the sole owner in fee simple of the Farm, which was located in the Town of Edgartown, Dukes County, Massachusetts. Following this acquisition and various related transfers of parcels by TNC to others, TNC held approximately 102 acres (comprised of 62 acres of property known as the “East Field” and 40 acres of property known as the “Central Field”). The remaining 113 acres of the Farm were transferred by TNC to other parties: (1) 40 to 50 acres were acquired by the F.A.R.M. Institute, portions of which ultimately were acquired by MV Regency Group, LLC and a private individual named Daniel Stanton; (2) 26 acres were acquired by a private individual named Roger Bamford; (3) Herring Creek Acquisition Company acquired: (a) two unnamed lots; (b) a property named Sanderling; (c) a property named Blue Heron; and (d) certain beach rights and other property enhancements;²⁴ and (4) Herring Creek Farm Landowner’s Association acquired from TNC a beach parcel, roadways, and a horse barn.²⁵

By grant of deed of conservation restrictions made by TNC, in favor of the Conservation Commission of the Town of Edgartown (“Conservation Commission”), the Conservation Commission acquired joint ownership of the conservation restrictions over Herring Creek Farm. Thus, after these various transactions were completed, portions of the 215 acres were held by TNC, the F.A.R.M. Institute, Roger Bamford, HCAC, and Herring Creek Farm Landowner’s Association, with the Conservation Commission holding as a joint owner with TNC conservation restrictions over a portion of the property.

A charitable contribution deduction was claimed by HCAC with respect to a bargain sale of property and certain preemptive rights pertaining to the initial acquisition of the property by TNC. Charitable deductions were also claimed by various members of the Wallace family with respect to undivided land interests and cash amounts paid to TNC as part of the transaction.²⁶

Description of Herring Creek Farm

Herring Creek Farm (“Farm”) is located in Edgartown, Massachusetts, on the island of Martha’s Vineyard. The Farm has bucolic vistas along Slough Cove Road, out over approximately 105 acres of open farmland, down to Edgartown Great Pond and the Atlantic

²⁴ As part of the transaction, TNC also acquired from HCAC certain preemptive rights that HCAC had acquired from the Wallaces in late 2000 and that pertained to the 1969 Agreement.

²⁵ TNC Response Letter to Committee dated April 15, 2004, *see* Appendix C.

²⁶ For a breakdown of the charitable contributions reported on the Forms 8283 pertaining to the preemptive rights and certain other in kind contributions, *see* Summary of Form 8283 and Form 8282 Filings, pp 32-34 below.

Ocean. The Farm is a waterfront farm located along the easterly shoreline of Edgartown Great Pond and is located on the shoreline of South Beach.

According to the documentation provided to the Committee, the most prominent features of the property were parcels of land such as the Moore Beach parcel (20 acres), the East Field (62 acres), described as the most ecologically important section slated for native grassland restoration, and the Central Field (40 acres). Two of the most significant structures on the property were the Monte Wallace and Neil Wallace homes located on the shoreline of Edgartown Great Pond. Rounding out the property were 10 numbered building lots and two homes, a parcel known as Blue Heron,²⁷ and a caretakers' cottage.²⁸ It appears that certain of these properties described by TNC as the most prominent and ecologically significant properties were retained by TNC and became subject to the conservation restrictions.

The 1969 Agreement Establishing Preemptive Rights

On December 30, 1969, four owners²⁹ of adjoining land in Edgartown, Massachusetts that included the Farm entered into an agreement (the "1969 Agreement") that provided certain rights and easements for access to public ways and for access to and use of certain beach property in exchange for mutual rights of first refusal to purchase their respective lands. The material provisions of the 1969 Agreement stated that: (1) the Wallaces granted to the Cohans specified rights of way across the Wallaces' land for access to the beach and to other bodies of water; (2) the Wallaces and the Cohans agreed that until January 1, 2010, as long as members of each family continued to own their property, "no use shall be made of" their land "other than for detached single family residences ... which residences shall not be designed intended for use, or used primarily for the production of rental income to the owner thereof"; and (3) the Wallaces and Cohans agreed that until January 1, 2010, they would not transfer any part of their land, other than within their own family, without first offering it for sale to those members of the other family who continued to own abutting property with houses. The agreement provided that in the event that the Wallaces wished to sell property between January 1, 2000, and December 31, 2009, the Cohans and Aldeborghs³⁰ had a right of first refusal to purchase Herring Creek Farm

²⁷ Blue Heron is a parcel of land located at 7 Butler's Cove Road. The property is located on the northeast corner of Herring Creek Farm and is non-waterfront property with private beach rights to South Beach. The Blue Heron house is 1,068 square feet and is located on the outskirts of Herring Creek Farm, adjacent to certain farm buildings. It was determined that the highest and best use of the property was either demolition and new construction or substantial remodeling with additions.

²⁸ The caretakers' cottage is part of the farm complex of buildings. The farm buildings have an average effective age of 50 years and are described as in average condition. Other structures on the property include two structures called the Sanderling house and the Movius cottage. The Movius cottage is located on lot 10, is in poor condition and is considered a "tear down."

²⁹ The four owners were Neil Wallace, Monte Wallace, Benjamin Harrison Cohan, and Hildegard Cohan. In 1969, Neil and Monte Wallace (through a trust) purchased 151 acres of property from Benjamin Harrison Cohan and his wife, Hildegard Cohan. The Wallaces purchased the property to establish summer vacation homes for their respective families.

³⁰ It is unclear who the Aldeborghs were or what relationship they had with the various parties to the 1969 Agreement.

for \$10,000 per acre plus the fair market value of the then existing residences and other structures on the land.

Thus, the 1969 Agreement created certain mutual rights and obligations among certain of the landowners with respect to property that included the Farm. These rights and obligations appear to have existed over 30 years later when TNC expressed interest in acquiring the Farm. These provisions appear to have granted the owners of certain land adjacent to the Farm the right to acquire the Farm at a specified price established in 1969, if the owners of the Farm attempted to sell the Farm to another party at any time before 2010.

Acquisition of Herring Creek Farm by TNC

During 2000, TNC expressed its desire to acquire and restrict the development and use of a portion of the Herring Creek Farm. In October 2000, TNC made an offer to the Wallaces, the owners of the Farm, to purchase the entire 215 acres for approximately \$35 million.³¹ The offer was ultimately rejected by the Wallaces, who at the time had pending with the local government authorities a request for approval of the 33-lot subdivision of the Farm.³² The Wallace's request for approval of the 33-lot subdivision on Herring Creek Farm was granted, with certain conditions, in November 2000. On November 21, 2000, the Board of Governors authorized the acquisition of the Farm for a purchase price not to exceed \$40 million.

On April 24, 2001, Stuart R. Johnson, the trustee of Herring Creek Farm Trust, signed a definitive agreement with TNC for the sale of the Farm. Pursuant to the April 24, 2001, definitive agreement, TNC agreed to purchase the Farm from the Wallaces for a price of \$64 million.³³ Under the terms of the agreement, the Wallaces had the right to specify the final purchase price based on a final appraisal, but TNC was not obligated to pay more than \$45.5 million from its own resources. The payment of the purchase price under the agreement contemplated that cash would be raised by TNC through some combination of gifts, loans, and re-sales of various portions of Herring Creek Farm.³⁴ In the event that the final purchase price designated by the Wallaces as a result of the appraisal exceeded \$64 million, TNC was under no obligation to complete the purchase unless it received additional contributions in an amount

³¹ TNC Response Letter to Committee dated April 15, 2004, *see* Appendix C. On October 23, 2000, the Board of Governors permitted TNC to enter into negotiations with the Wallace family for the purchase of the Wallace family tract. Phase 1 allowed for the transfer of 15 acres plus \$1.6 million in cash to the Cohan/Aldeborgh families, the holders of the right of first refusal.

³² TNC Response Letter to Committee dated April 15, 2004, *see* Appendix C.

³³ The \$64 million figure was comprised of the following: (1) \$27 million (cash) received from the F.A.R.M. Institute, Inc.; (2) \$7,250,000 received from Roger Bamford for the purchase of an existing residence; (3) \$9,250,000 representing a portion of the proceeds of a Bank of America loan obtained, guaranteed, and collateralized by Roger Bamford and which was non-recourse to TNC; (4) \$1 million credit for TNC's initial deposit for which TNC was later reimbursed by the Bank of America loan; (5) \$1 million promissory note secured by a mortgage on the Herring Creek Farm lot; and (6) \$18.5 million gift contributed by the Wallace Foundation.

³⁴ Letter dated April 24, 2001, from TNC (signed by Wayne A. Klockner) to Stuart R. Johnson, *see* Appendix M.

equal to the excess.³⁵ In short, TNC was not responsible for the portion of the purchase price (as finally determined) that exceeded \$45.5 million. The excess purchase price over \$45.5 million was to be funded by others, with any shortfall to be provided for by members of the Wallace family.

Also, on April 24, 2001, TNC signed a definitive agreement with the F.A.R.M. Institute, Inc., for a sale of a portion of Herring Creek Farm.

In a separate transaction, F.A.R.M. Institute, Inc., signed a definitive agreement with MV Regency Group, LLC³⁶ for the sale of another portion³⁷ of Herring Creek Farm.

Several months later, on July 17, 2001, MV Regency Group, LLC signed a purchase and sale agreement with a private individual, Daniel W. Stanton, for the sale of another portion of Herring Creek Farm.

Certain Herring Creek Farm closing documents stated that upon completion of all the conveyances and payments, and upon TNC securing the agreement of the Wallaces also to sign the document, the Cohan descendants were to: (1) execute and file a stipulation of dismissal with prejudice, without costs, and waiving all rights of appeal of all claims and counterclaims in the litigation currently pending between the Wallaces and Cohan descendants and (2) execute a general release of all claims against the Wallaces, in return for a mirror image release from the Wallaces of all claims against the Cohan descendants.³⁸

Funding for the Acquisition of Herring Creek Farm

Charitable gifts made by Herring Creek Farm Trust to TNC

³⁵ Letter dated January 8, 2001, from Frank Giso III, (Choate, Hall & Stewart) to Stuart R. Johnson, David A. Peters, Christopher H. Milton and Thomas P. Bloch, *see* Appendix M. Documentation provided to the Committee staff suggests that if the final purchase price determined by the Wallaces exceeded the initial \$64 million purchase price and the gifts made from Wallace family members were not adequate to cover the difference between \$45.5 million and the final purchase price, then the Wallaces were nevertheless required to sell the property to TNC for an amount equal to the total of \$45.5 million, plus the current value of gifts made (calculated as of the day before closing). Any remaining unpaid portion of the final purchase price would generate a bargain sale gift from Herring Creek Farm Trust to TNC. A letter concluded that TNC should have the right to obtain specific performance of a sale of the property on these terms. *See* On June 5, 2001, Coleman & Sons Appraisal Group appraised the fair market value of Herring Creek Farm for \$78 million. On July 17, 2001, TNC obtained an independent professional appraisal from Meredith & Grew Inc., who appraised the fair market value of Herring Creek Farm for the same amount.

³⁶ TNC Response Letter to Committee dated April 15, 2004, *see* Appendix C. MV Regency Group, LLC was a development company managed by David Peters and owned by the David M. Letterman Trust.

³⁷ Letter dated June 3, 2003, from Hans P. Birlle to Philip Tabas regarding Herring Creek Farm, *see* Appendix M. The documentation provided by TNC states that F.A.R.M. Institute, Inc., sold approximately 39 acres to MV Regency Group, LLC.

³⁸ Executed agreements between TNC, HCAC, and F.A.R.M. Institute, Inc.

On April 24, 2001, as part of the definitive agreement between TNC and the Herring Creek Farm Trust, TNC and the trust expressed their intentions with respect to gifts to be made by certain persons and entities affiliated with the trust.³⁹ The parties acknowledged that if the purchase price under that agreement exceeded \$45.5 million, TNC would request the trust and related parties to consider making gifts as described in the letter. The trust agreed to encourage the owners of the Blue Heron Parcel, the Moore Beach Parcel, and the Sliver Parcel to gift those parcels to TNC, and to encourage certain members of the Wallace family to make, on or before June 15, 2001, gifts of cash or other assets having a value of at least \$9.5 million. The purpose of the contemplated gifts was to aid TNC in achieving its goal of preserving large areas of farmland on Martha's Vineyard.

The agreement also provided that any Wallace family gifts were to be evidenced by a charitable pledge agreement and interest free promissory note, enforceable against the Wallace family donors unless a bargain sale gift was made by the trust pursuant to the parties' agreement. In the event that the purchase price exceeded \$55 million and TNC was unable to raise the additional funds from the Wallace family, or the Wallace family failed to honor a \$9.5 million pledge, the trust would make a bargain sale gift of any "shortfall"⁴⁰ to TNC. The letter of intent provided TNC a break up fee of \$3 million if certain circumstances occurred. A confidentiality agreement executed by the parties on December 11, 2000, was incorporated by reference.

Cash pledge of Real Estate Equities Limited Partnership and Wallace Foundation

On June 21, 2001, the Real Estate Equities Limited Partnership, a Delaware limited partnership ("the Partnership") executed a "Charitable Pledge Agreement," with TNC as pledgee, pursuant to which the Partnership pledged to pay \$9.5 million to TNC. The pledge contemplated that large areas of farmland on Martha's Vineyard would be preserved. The parties executed a non-negotiable promissory note to evidence the commitment to complete the gift contemplated in the pledge agreement.⁴¹ The promissory note in the amount of \$9.5 million was executed by the Partnership on June 21, 2001. Under the note, the Partnership was obligated to pay TNC up to \$9.5 million when TNC acquired farmland on Martha's Vineyard as part of its program to preserve the same, provided that TNC gave the Partnership at least seven days written notice.⁴²

³⁹ Letter dated April 24, 2001, from TNC (signed by Wayne A. Klockner) to Stuart R. Johnson, *see* Appendix M.

⁴⁰ For these purposes, shortfall means the amount equal to the purchase price under the agreement minus the total of \$45.5 million, plus the total of cash gifts actually funded by the Wallace family donors, plus any credit against the purchase price received by TNC for promissory notes delivered by the Wallace family donors but not funded with cash by the closing under the purchase agreement.

⁴¹ Letter dated June 21, 2001, from Herring Creek Farm Trust to TNC (formal submission of charitable pledge agreement and non-negotiable promissory note), *see* Appendix M.

⁴² Interest did not accrue under the note until the maturity date, an undefined term which appeared to mean the date (including the up to seven day notice period) on which TNC requested payment under the note.

On July 18, 2001, the Wallace Foundation⁴³ remitted to TNC (by wire transfer) \$18.5 million to fully satisfy the promissory note and charitable pledge agreement obligations of the Partnership. The letter specifically stated that the \$18.5 million satisfied in full a certain non-negotiable note dated June 21, 2001, of the Partnership in the original principal amount of \$9.5 million as well as a charitable pledge agreement also dated June 21, 2001, of the Partnership in favor of TNC.⁴⁴

On July 20, 2001, TNC closed on the purchase of the Farm by paying cash consideration of \$45.5 million and executing a promissory note in the amount of \$1 million, payable to Stuart R. Johnson, Trustee of Herring Creek Farm Trust, payable in full on July 19, 2004. By prior agreement, TNC and Stuart R. Johnson agreed that TNC could pay up to \$1 million of the purchase price by delivering at closing a promissory note in such amount.⁴⁵

Transfer of Preemptive Rights, Bargain Sale by HCAC to TNC, and Tax Indemnity Payments

In late 2000, certain preemptive rights held by the Wallaces were transferred to HCAC.⁴⁶ TNC took affirmative steps to obtain the approval from HCAC to waive these rights of first refusal when TNC acquired the Farm. HCAC expressed a willingness to make a bargain sale gift to TNC of the appraised fair market value of the preemptive rights under the 1969 Agreement in excess of the value of the cash and real estate conveyances expressly described in the agreement.

Bargain sale gift and TNC's tax indemnity obligations

On June 29, 2001, TNC and HCAC executed an agreement regarding a bargain sale gift of the preemptive rights⁴⁷ and certain tax payments. The agreement acknowledged that HCAC had conveyed to TNC certain preemptive rights which had been held by HCAC pursuant to the 1969 Agreement, and that such rights had been appraised prior to the conveyance at \$14

⁴³ Forms 990-PF from 2000, 2001 and 2002, show that the Wallace foundation is an entity by the name of the "Monte J. Wallace Foundation" with Monte J. and Anne H. Wallace as trustees and with a principal address of 600 Atlantic Avenue Suite 2000 Boston, Massachusetts 02210, *see* Appendix L.

⁴⁴ Letter dated July 18, 2001, from the Wallace Foundation to TNC, *see* Appendix M.

⁴⁵ Letter dated April 24, 2001, from TNC (signed by Wayne A. Klockner) to Stuart R. Johnson, *see* Appendix.

⁴⁶ TNC Response Letter to Committee dated April 15, 2004, *see* Appendix C.

⁴⁷ A letter from TNC to Stuart R. Johnson dated April 24, 2001, outlined the effect of bargain sale gift on TNC's requirements regarding approval of an appraisal under the purchase agreement. The letter stated that in the event that Herring Creek Trust does elect to make a bargain sale gift of some portion of the Herring Creek Farm, TNC will review and approve the appraisals for Herring Creek Farm based on the figure that represents the actual net price to TNC rather than based upon the full fair market value stated in HCAC's appraisal. An example was provided in the letter stating that if Herring Creek Trust's appraisal indicated a fair market value of \$70 million and Herring Creek Trust elected to make a bargain sale gift in the amount of \$15 million, then TNC would evaluate the appraisal to ensure that TNC and its Board were satisfied that the fair market value of Herring Creek Farm was at least \$55 million (rather than the higher \$70 million figure) and would grant or withhold their approval of the appraisal on that basis. Letter dated April 24, 2001, from TNC (signed by Wayne A. Klockner) to Stuart R. Johnson, *see* Appendix M.

million.⁴⁸ The agreement provided that HCAC was to report a bargain sale gift amount with respect to the conveyance not to exceed \$2,066,000, based on the excess of the value of the rights over the value and amount of certain items transferred by TNC to or on behalf of HCAC. The agreement provided that the transfer of the rights would be treated as a long-term capital transaction for tax purposes. The agreement further acknowledged that TNC and HCAC had executed a separate agreement regarding the transfer that, among other things, obligated TNC to make certain tax indemnification payments to HCAC.⁴⁹ TNC and HCAC agreed that the payment owed by TNC to HCAC under that agreement was \$1,484,000, subject to further adjustments, as the indemnification provisions were to remain in effect in the event of any State or Federal tax audit.

Valuation of the pre-emptive rights

On August 15, 2001, Meredith & Grew, Inc., submitted an appraisal report to Daniel J. Gleason (attorney for HCAC) for the right of first refusal and valued such right for \$14 million. The analysis submitted indicated a value ranging from \$12.9 million to \$17 million for the right, but it was ultimately concluded that the right was worth \$14 million. Meredith & Grew, Inc., stated that the \$14 million figure represented a 21.9 percent discount when applied against the \$64 million deeded price. Furthermore, it was estimated that the property that was subject to the right of first refusal comprised an estimated 186 acres of the 220-acre Herring Creek Farm.

On August 25, 2001, Appraisal/Economics, Inc., determined that the rights of first refusal represented an impairment to the marketability on the sale of 175 acres and that the rights were worth \$14 million.⁵⁰

Transfers made by TNC in exchange for waiver of preemptive rights

In exchange for the waivers of the preemptive rights, TNC made transfers valued at \$11,931,755⁵¹ representing the following: (1) \$1.7 million as a reimbursement of the legal expenses with respect to the litigation concerning the validity of the 1969 agreement and attempts to secure a 50-lot and 33-lot subdivision approval with respect to Herring Creek Farm; (2) \$402,755 representing a payment of HCAC's legal expenses; (3) \$1,484,000 representing a gross up payment representing the anticipated taxes on the consideration received for the waiver of the preemptive rights; (4) \$4,750,000 representing the conveyance of two buildable lots to HCAC for no consideration; (5) \$1 million representing the conveyance of the Sanderling lot to

⁴⁸ In a summary appraisal report dated July 15, 2001, Meredith & Grew Inc., determined that the right of first refusal had a fair market value of \$14 million, *see* Appendix M.

⁴⁹ TNC stated that HCAC insisted on the indemnity as the only acceptable alternative to payment by TNC of the value of pre-emptive rights. TNC concluded that providing the tax indemnity was the least costly alternative and that the sum of the value of the indemnity and \$11,931,755 paid in consideration was less than the appraised value of the pre-emptive rights. TNC Response Letter to Committee dated April 15, 2004, *see* Appendix C.

⁵⁰ Letter entitled, "Determination of the FMV of a right of first refusal on certain real estate in Edgartown, Massachusetts," *see* Appendix M.

⁵¹ TNC Response Letter to Committee dated April 15, 2004, *see* Appendix C.

HCAC for no consideration; (6) \$625,000 representing the conveyance of the Blue Heron lot to one of the family members for no consideration; (7) \$750,000 representing the conveyance of beach rights and other property enhancements to HCAC for no consideration; and (8) \$1,222,000 representing the release by TNC of the preemptive rights under the 1969 agreement.

Tax Payments

A letter dated October 18, 2001, outlined the concept of “tax-make whole payment” (“TMW”).⁵² TNC and HCAC agreed that TNC would cover any tax liability incurred by HCAC as a result of TNC’s conveyance of lots 2 and 3, Blue Heron, and Sanderling⁵³ to HCAC for no consideration. The letter further stated that TNC would receive a credit against the TMW payment to reflect the charitable deductions that HCAC would be able to pass through to its members based upon HCAC having made a bargain sale gift to TNC of some portion of the preemptive rights under the 1969 Agreement.

The letter calculated the TMW payments prior to giving any effect to the bargain sale gift by multiplying the fair market value of \$6,375,000 by an agreed upon Federal⁵⁴ and State⁵⁵ formula. Further, the letter calculated the bargain sale gift component by using the fair market value of the pre-emptive rights as the base. Having previously determined through various appraisals that the value of the preemptive rights was worth at least \$14 million, the bargain sale gift⁵⁶ was calculated by subtracting \$14 million from the total consideration received by HCAC from TNC in connection with TNC’s acquisition of the preemptive rights. It was ultimately determined that HCAC was to report a bargain sale gift not to exceed \$2,068,245 based on the excess of the value of the rights over the value of certain transfers by TNC (i.e., \$14 million minus \$11,931,755).

⁵² Letter from Frank Giso III, PC to Hans P. Birle, Esq., Regarding the Status of Negotiations with Herring Creek Acquisition Company Regarding “Tax Make-Whole Payment” dated October 18, 2001, *see* Appendix M.

⁵³ The fair market value of lots 2 and 3, Blue Heron, and Sanderling were collectively valued at \$6,375,000. A summary report provided by Meredith & Grew Inc., appraised lots 2 and 3, Blue Heron, and Sanderling as follows, \$2,250,000, \$2.5 million, \$625,000, and \$1 million, respectively. Summary appraisal report by Meredith & Grew Inc., for Blue Heron, Sanderling and Lots 2 and 3 dated July 15, 2001, *see* Appendix M.

⁵⁴ The Federal component was calculated as follows: \$6,375,000 multiplied by .2 and then divided by .8 for a value of \$1,593,750. Letter from Frank Giso III, PC to Hans P. Birle, Esq., Regarding the Status of Negotiations with Herring Creek Acquisition Company Regarding “Tax Make-Whole Payment” dated October 18, 2001, *see* Appendix M.

⁵⁵ The State component was calculated as follows: \$6,375,000 multiplied by .05 and then divided by .95 for a value of \$355,526. Letter from Frank Giso III, PC to Hans P. Birle, Esq., Regarding the Status of Negotiations with Herring Creek Acquisition Company Regarding “Tax Make-Whole Payment” dated October 18, 2001, *see* Appendix M.

⁵⁶ The TMW payment was reflected as one of the line items in calculating the bargain sale component. The letter stated in relevant part that, the bargain sale gift would increase as the TMW payment is decreased to reflect the credit for the bargain sale gift. Letter from Frank Giso III, PC to Hans P. Birle, Esq., Regarding the Status of Negotiations with Herring Creek Acquisition Company Regarding “Tax Make-Whole Payment” dated October 18, 2001, *see* Appendix M.

Charitable Letter of Acknowledgment

On March 8, 2002, TNC sent HCAC a letter acknowledging a charitable gift from HCAC.⁵⁷ In that letter, TNC treated the total value of consideration from TNC to HCAC in return for the conveyance of HCAC's interest under a 1969 agreement which encumbered the Herring Creek Farm to be \$11,931,755. This consisted of: (1) \$6,375,000 relating to the conveyance of Lots 2 and 3, Sanderling and Blue Heron; (2) \$3,586,755 for cash payments to or on behalf of HCAC; (3) \$750,000 for beach rights and enhancements; and (4) \$1,220,000 for the release of preemptive rights encumbering the Cohan and Aldeborgh properties. TNC stated that the value of HCAC's interest in the 1969 agreement in excess of \$11,931,755 "represents a bargain sale gift to TNC and the amount of any charitable contribution deduction taken by HCAC or its members is limited to such excess."⁵⁸ In the Form 8283 provided by HCAC to TNC on March 8, 2002, HCAC reported the appraised value of the real estate and preemptive rights conveyed to TNC to be \$14 million and the amount claimed by HCAC as a charitable deduction to be \$2,068,245.

Transfer of Portions Herring Creek Farm by TNC to Various Parties

After TNC acquired Herring Creek Farm, a series of transfers of parcels to other parties took place. The initial purchase of the Farm and subsequent property transfers of parcels of the Farm were broken down into three separate agreements⁵⁹: (1) the Sellers/TNC agreement that covered everything currently owned by Herring Creek Farm Trust as well as all the adjacent properties owned by various Wallace family members (for a fixed stated price); (2) the TNC/F.A.R.M. Institute, Inc., agreement that covered portions of the property conveyed from TNC to the F.A.R.M. Institute, Inc. (for \$28 million); and (3) the F.A.R.M. Institute, Inc./MV Regency Group, LLC agreement that covered four building lots that were transferred from F.A.R.M. Institute, Inc. to MV Regency Group LLC.

Transfer to the F.A.R.M. Institute

On April 24, 2001, TNC signed a definitive agreement with the F.A.R.M. Institute, Inc.,⁶⁰ for a sale of the portion of Herring Creek Farm.⁶¹ The overall purchase price was \$28 million.⁶²

⁵⁸ Letter dated March 8, 2002, from Dennis B. Wolkoff, Vice President, TNC, to Herring Creek Acquisition Company, LLC, c/o Robert Hughes, *see* Appendix M.

⁵⁹ Letter dated January 8, 2001, from Frank Giso III, (Choate, Hall & Stewart) to Stuart R. Johnson, David A. Peters, Christopher H. Milton and Thomas P. Bloch, *see* Appendix M. A TNC press release stated that "[t]hrough portions of Herring Creek Farm will change ownership multiple times throughout the course of the transaction, the conservation restrictions set by TNC must be adhered to by all buyers."

⁶⁰ F.A.R.M. Institute, Inc., is a local non-profit organization whose mission includes the preservation of farms and the promotion of agricultural education. TNC Response Letter to Committee dated April 15, 2004, *see* Appendix C.

⁶¹ Letter dated April 24, 2001, Purchase and Sale Agreement between TNC, as Seller and the F.A.R.M. Institute, Inc., as Purchaser, Regarding a Portion of Herring Creek Farm Edgartown, Dukes County, Massachusetts, *see* Appendix M. All of the consideration received by TNC from F.A.R.M. Institute, Inc., was used by TNC to finance

Subject to certain adjustments and apportionments, F.A.R.M. Institute, Inc., was required to remit \$27 million. With respect to the remaining \$1 million of the purchase price, TNC (seller) assigned and F.A.R.M. Institute, Inc. (purchaser) assumed all of the seller's obligations under the promissory note secured by a mortgage on the Herring Creek Farm lot. TNC made the following transfers to the F.A.R.M. Institute, Inc: (1) title to Herring Creek Farm lot; (2) a 99-year ground lease on a piece of property named the Central Field; and (3) title to four building lots, one of which was the site of one of the existing Wallaces residences.⁶³

By prior agreement, F.A.R.M. Institute, Inc., signed a definitive agreement with MV Regency Group, LLC for the sale of a portion of Herring Creek Farm. Pursuant to the definitive agreement, F.A.R.M. Institute, Inc., transferred four building lots to MV Regency Group, LLC.⁶⁴

Transfer to Bamford

The documentation indicates that at some point, Roger Bamford held the titles of President, Treasurer, and Director of Herring Creek Farm, but ultimately resigned from those positions. An agreement dated October 18, 2000, indicated that Roger Bamford would lend TNC up to \$40 million to finance the acquisition of the Wallace properties and would provide TNC an indemnity in the amount of \$1 million.⁶⁵ TNC stated that the purpose of the agreement with Roger Bamford was to enable TNC to complete the transaction without out-of-pocket costs either for the acquisition of Herring Creek Farm or for securing waiver of the pre-emptive rights held by HCAC.⁶⁶

The agreement specifically stated that if TNC was successful in signing an agreement with the Wallaces for the purchase of the Wallace land, Roger Bamford would make a loan to TNC in the amount of the purchase price owed by the Wallaces and TNC would execute and deliver to Roger Bamford as evidence of, and security for, the acquisition loan, a non-recourse promissory note from the Bank of America bearing a seven percent per annum interest rate. The

the purchase of Herring Creek Farm from the Wallaces. TNC Response Letter to Committee dated April 15, 2004, *see* Appendix C.

⁶² A deposit in the amount of \$100,000 was placed in escrow with respect to this transaction. Letter dated April 24, 2001, Purchase and Sale Agreement between TNC, as Seller and the F.A.R.M. Institute, Inc., as Purchaser, Regarding a Portion of Herring Creek Farm Edgartown, Dukes County, Massachusetts, *see* Appendix M.

⁶³ It appears the total amount of acreage transferred to F.A.R.M. Institute, Inc., was 40 to 50 acres.

⁶⁴ Subsequently, on July 17, 2001, MV Regency Group, LLC signed a purchase and sale agreement with another party for the sale of a portion of Herring Creek Farm. TNC was neither a party to the F.A.R.M. Institute Inc. agreement with MV Regency Group, LLC nor to the subsequent transfer of certain lots by MV Regency Group, LLC to another party.

⁶⁵ Letter dated October 18, 2000, outlining the terms of the acquisition loan, *see* Appendix M. Documentation provided by TNC indicated that Bamford pledged to make a sizable donation to cover the balance of the purchase price and the costs of the transaction. Letter dated June 3, 2003, from Hans P. Birlle to Philip Tabas regarding Herring Creek Farm, *see* Appendix M.

⁶⁶ TNC Response Letter to Committee dated April 15, 2004, *see* Appendix C.

loan was intended to provide TNC with the funds needed to fully fund the \$45.5 million purchase price, make cash payments to HCAC, and recover its other transactional costs, including legal fees and transfer taxes.⁶⁷

The agreement further granted Roger Bamford an option to purchase for fair market value all or any portion of the Wallace land covered by the purchase mortgage.⁶⁸ Under the arrangement, Roger Bamford would purchase two lots for their final appraised values.⁶⁹ Pursuant to such arrangement, TNC transferred to Roger Bamford a lot (lot 6⁷⁰) on which an existing Wallace residence was situated for \$7,250,000.⁷¹ A second lot (lot 5⁷²) was sold in December 2003, at fair market value, for \$4,750,000.⁷³

Transfer to Herring Creek Farm Landowners Association, Inc.

The Herring Creek Farm Landowners Association, Inc. is a non-profit Massachusetts corporation, organized under the provisions of Chapter 180 of the Massachusetts General Laws, charged with the duties and invested with the power prescribed by law and set forth in its Articles of Organization, By-Laws and the Declaration. The Conservancy had the right to retain ownership of the roadways at the farm and the beach lot, subject to certain travel and use easements in favor of other landowners at Herring Creek Farm. TNC conveyed the so-called “Beach Parcel,” and all roadways on Herring Creek Farm and the so-called “Horse Barn” structure in the “Central Field” to Herring Creek Farm Landowner’s Association, Inc. As a means of avoiding the risk of liability as owner in the event of personal injury or death, TNC transferred these portions for no consideration to the Association.

Conservation Restrictions Applicable to the Acquired Property

⁶⁷ TNC Response Letter to Committee dated April 15, 2004, *see* Appendix C.

⁶⁸ TNC agreed that if it received any net sales proceeds from the sales to Bamford or the F.A.R.M. Institute, Inc., in excess of the total costs of the transaction, the excess would be used to reduce the Bank of America loan. Bamford agreed to make a contribution to TNC in an amount sufficient to enable TNC to pay off the loan. TNC Response Letter to Committee dated April 15, 2004, *see* Appendix C.

⁶⁹ TNC Response Letter to Committee dated April 15, 2004, *see* Appendix C.

⁷⁰ Lot 6 is comprised of 15.86 acres and includes the existing “Neil Wallace residence” and an abandoned cottage known as Movius Camp. Meredith & Grew Inc., estimated the fair market value of lot 5 in the amount of \$7,250,000 million. Letter dated July 9, 2001, from Meredith & Grew Inc., to Hans P. Birle, Counsel for TNC, *see* Appendix M.

⁷¹ TNC Response Letter to Committee dated April 15, 2004, *see* Appendix C.

⁷² Lot 5 is comprised of 9.62 acres that fronts Edgartown Great Pond. Meredith & Grew Inc., estimated the fair market value of lot 5 in the amount of \$4.7 million. Letter dated July 9, 2001, from Meredith & Grew Inc., to Hans P. Birle, Counsel for TNC, *see* Appendix M.

⁷³ The proceeds from the sale were used to reduce a loan taken out with the Bank of America. TNC Response Letter to Committee dated April 15, 2004, *see* Appendix C.

On July 13, 2001, TNC and the Town of Edgartown entered into a Memorandum of Understanding concerning the deed of conservation restrictions⁷⁴ relating to the Farm.⁷⁵ TNC stated that it desired to convey conservation restrictions and the Conservation Commission of the Town of Edgartown determined that it would be desirable and beneficial to enforce the conservation restrictions in order to protect the property's conservation values, while permitting uses of the property that did not impair the property's conservation values and that were not inconsistent with the purpose of the conservation restriction. The conservation restrictions were intended to maintain the property such that it remain predominantly in or be restored to its natural, open, agricultural and scenic state in perpetuity, except for limited portions of the property to be developed with selected improvements and related structures as permitted in such a manner as to protect the "conservation values."⁷⁶

The conservation restriction agreement resulted in a portion of property that consisted of a subdivision of 33 lots,⁷⁷ a separate parcel containing 56 acres (lot 70, the East Field) and two beach parcels containing approximately 20 acres (lots 104 and 104A or the Beach).

TNC described the conservation restriction pertaining to Herring Creek Farm as follows⁷⁸:

⁷⁴ The deed of conservation restrictions dated July 2001, specifically stated that TNC and the Conservation Commission of the Town of Edgartown intended to: (1) enhance the conservation values of the property by limiting the number of developable lots and the size and number of permitted structures thereon; (2) manage and restore the native grassland on portions of the property; (3) designate other portions of the property for agricultural activities; (4) manage the beach to protect the fragile nature of this landform and its species of plant and animal; (5) prohibit the introduction of and providing for the removal of certain invasive plant species; and (6) prohibit the use of synthetic fertilizer and the application of biocides, herbicides or pesticides without TNC's prior approval in consultation with the Conservation Commission of the Town of Edgartown and the Association and encouraging the use of native landscaping and restoration. Deed of Conservation Restrictions, Herring Creek Farm, Edgartown, MA dated July 2001, *see* Appendix M.

⁷⁵ TNC Response Letter to Committee dated April 15, 2004, *see* Appendix C.

⁷⁶ TNC and the Conservation Commission of the Town of Edgartown jointly expressed the desire to preserve the natural, scenic, agricultural and open space values of the property; to protect the shoreline and water quality of Edgartown Great Pond and Crackatuxet Cove; to protect globally rare sandplain grasslands, savannas, oak woodlands, heathlands and other natural communities; to preserve agricultural and farming uses on portions of the property; to promote the restoration of native habitats; to increase the populations of native animals, birds, insects and other species; and to prevent habitat fragmentation and to promote restoration of native grassland. TNC and the Conservation Commission of the Town of Edgartown recognized the conservation values of the property and shared the common goal of protecting these conservation values. Deed of Conservation Restrictions, Herring Creek Farm, Edgartown, MA dated July 2001, *see* Appendix M.

⁷⁷ Originally approved for a 33-lot subdivision by both the Planning Board and the Martha's Vineyard Commission, the agreement reached by the parties provides for six additional houses, all to be located within the numbered lots subject to restrictions and conservation easements. *See* TNC response letter to Senate Finance Committee dated April 15, 2004, at 22. To this effect, a TNC press released stated that "[a]s a result of the conservation restrictions, the number of new houses to be built on the land is limited to six, none of which are sited in the sensitive restoration area." <http://nature.org/pressroom/links/art10072.html>.

⁷⁸ TNC Response Letter to Committee dated April 15, 2004, *see* Appendix C.

a conservation restriction is a permanent encumbrance on the entire Farm and, in pertinent part: (a) establishes pristine areas of Farm with exceptional wildlife and plant species habitat where no development will ever be permitted; (b) establishes on those lots within the Farm where limited residential development will be permitted, so-called “development envelopes” outside of which no improvements will be permissible, and joins together the resulting open space on each lot into meaningful tracts of contiguous habitat; (c) imposes key restrictions on the Farm, including limiting public access to sensitive grasslands and beach areas, limitations on the types and numbers of domesticated pets that may be kept on the Farm, on the planting of non-native grasses and plant species outside the development envelopes; (d) incorporates the Conservancy’s science-based habitat management techniques, such as prescribed burning of grassland areas and beach management activities; and (e) prohibits development of shore-hugging mansions that would irreparably alter the character of the Farm and its unique vistas and “viewsheds.”

TNC reserved the right to enforce the terms of the conservation restriction. The Town of Edgartown and TNC agreed to meet at least annually at an open space management meeting to review and discuss ongoing monitoring and enforcement activities.⁷⁹ The parties also agreed to cooperate in implementing aggressive conservation strategies, including soil and water conservation, restoration of native grasslands, active management of the beach area and open spaces, and selective cutting and clearing of vegetation for habitat protection.⁸⁰ TNC prepared a baseline report to document the condition of Herring Creek Farm upon acquisition as a means of measuring future enforcement efforts as well as the success of the program.

⁷⁹ TNC Response Letter to Committee dated April 15, 2004, *see* Appendix C.

⁸⁰ TNC Response Letter to Committee dated April 15, 2004, *see* Appendix C.

The following table shows certain information reported on the Forms 8283 provided to TNC and filed with the IRS by donors with respect to the Martha's Vineyard properties.

Table 8, Summary of Form 8283 filings

Name of donor	Date of Form 8283	Date of Donation	Description of Donation	Appraised FMV reported on Form 8283	Date property was acquired	How acquired	Other comments
Herring Creek Acquisition Company, LLC	3/8/02	7/20/01	Real estate/preemptive rights	\$14,000,000	1/96	Exchange	Amount claimed as a deduction was \$2,068,245; bargain sale amount received reported as \$11,931,755
Jonathan R. Wallace & Lisa S. McGovern	9/9/02	7/20/01	10% undivided interest Slough Cove Road (SCR) parcel	110,000	11/86	Purchase	See Form 8282 info. below
Anthony G. & Elizabeth W. Trase	9/9/02	7/20/01	10% undivided interest SCR parcel	110,000	11/86	Purchase	See Form 8282 info. below
William Gardner & Page C. Wallace	9/9/02	7/20/01	10% undivided interest SCR parcel	110,000	11/86	Purchase	See Form 8282 info. below
John H. Wallace	9/9/02	7/20/01	10% undivided interest SCR parcel	110,000	11/86	Purchase	See Form 8282 info. below
Robert E. & Julia W. Bennett	9/9/02	7/20/01	10% undivided interest SCR parcel	110,000	11/86	Purchase	See Form 8282 info. below
Bradford S. & Ann F. Wallace	9/9/02	7/20/01	10% undivided interest	110,000	11/86	Purchase	See Form 8282 info. below

			SCR parcel				
Neil W. & Elise R. Wallace	9/9/02	7/20/01	20% undivided interest SCR parcel	220,000	11/86	Purchase	See Form 8282 info. below
Monte J. & Anne H. Wallace	9/9/02	7/20/01	20% undivided interest SCR parcel	220,000	11/86	Purchase	See Form 8282 info. below
Neil W. & Elise R. Wallace	9/9/02	7/20/01	50% undivided interest in other SCR parcel	12,500	----	Purchase	
Monte J. & Anne H. Wallace	9/9/02	7/20/01	50% undivided interest in other SCR parcel	12,500	----	Purchase	
Neil W. & Elise R. Wallace	9/9/02	7/20/01	50% undivided interest SCR ocean front	380,000	1984-1989	Purchase	
Monte J. & Anne H. Wallace	9/9/02	7/20/01	50% undivided interest SCR ocean front	380,000	1984-1989	Purchase	
Windsor Capital Corporation	9/9/02	7/20/01	Herring Creek Farm; 34 building lots, beach front and wood lot on approx. 205 acres	76,115,000	1969-1980s	Purchase	Amount received for bargain sale was \$64.0 million; donor's basis was \$11.9 million; see Form 8282 info. below

The following table summarizes certain information reported by TNC on Forms 8282 filed by TNC with respect to the Martha's Vineyard properties.

Table 9, Summary of Form 8282 Filings

Name of donor	Description of property	Date of donation	Date of sale by TNC	Amount received by TNC	Value reported on Form 8283
Windsor Capital Corporation	Herring Creek Farm	7/20/01	7/24/01	\$35,250,000	\$76,115,000
Monte J. & Anne H. Wallace	20% undivided interest	7/20/01	2/15/02	125,000	220,000
John H. Wallace	10% undivided interest	7/20/01	2/15/02	62,500	110,000
Neil W. & Elise R. Wallace	20% undivided interest	7/20/01	2/15/02	125,000	220,000
Jonathan R. Wallace & Lisa S. McGovern	10% undivided interest	7/20/01	2/15/02	62,500	110,000
William Gardner & Page C. Wallace	10% undivided interest	7/20/01	2/15/02	62,500	110,000
Anthony G. & Elizabeth W. Trase	10% undivided interest	7/20/01	2/15/02	62,500	110,000
Bradford S. & Ann F. Wallace	10% undivided interest	7/20/01	2/15/02	62,500	110,000
Robert E. & Julia W. Bennett	10% undivided interest	7/20/01	2/15/02	62,500	110,000

III. CBP Transaction – Lake Huron

TNC prepared the following summary of this transaction, also described in *The Washington Post*, for its June 13, 2003 Board of Governors meeting.

CONSERVATION BUYER TRANSACTION SUMMARY—C

Site or Project Name: Northern Lake Huron, MI

Purchaser Name: Jerrold Jung, as Trustee for Jerrold M. Jung Trust

Land: 184.5 acres of land located on the shoreline of northern Lake Huron.

Date of Sale: 12/9/2002

1. **Consistency with *Conservation by Design*:** The Northern Lake Huron shoreline is a portfolio site identified within the Great Lakes eco-regional plan. This shoreline was identified as one of the richest and most productive biological areas in the country by TNC science and protection staff and as a critical Biodiversity Investment Area by the U.S. Environmental Protection Agency. The shoreline where this project is located features nine globally rare communities and at least 13 federally endangered, threatened or listed species. The site also contains at least 21 globally rare species of plants and animals, and 60 species rare in the state of Michigan. More than 250 species of migratory songbirds and waterfowl fly through this shoreline and use this habitat as a critical resting and feeding stopover site.
 - **Threat:** The property was threatened with development into a golf course and 27 residential housing units. The primary conservation goal is to prevent further habitat fragmentation.
 - **Conservation Easement:** The permanent conservation easement prevented any further development of the property and limited development to the existing buildings (one residence, one log cabin, one pole barn, one boat dock); all except the log cabin may be replaced in the same location as the existing building. The log cabin can not be replaced if it is removed or destroyed. The easement also prohibits any commercial use of the property, disturbance of native vegetation, agriculture, forestry, and other changes to and economic uses of the land.
2. **Valuation Substantiation:** TNC obtained an independent, professional appraisal of the property. The appraisal, as of January 1, 2002, indicated a value for the property without use restrictions to be \$2,298,500. The appraisal of the property with the restrictions imposed indicated a value of \$1,062,000. This creates a value of the easement of \$1,236,500. The appraisal was obtained prior to price being established in the purchase agreement.
3. **Marketing Efforts:** TNC sought potential buyers by word of mouth in conversations with Michigan Chapter Trustees. One of the current Trustees suggested to the MI State director, among other names, that Mr. Jung might be a prospect for this property. TNC established a written outline of the proposed conservation terms and conditions prior to sale. The only person to emerge as a possible conservation buyer was Jerry Jung. No other marketing efforts were undertaken.
4. **Buyer's Relationship to TNC:** Buyer is a former MI Chapter Trustee, having served on the Chapter Board from 1995 to 1998.
5. **Structure of the Deal:** TNC purchased the property by buying two parcels of land without restrictions for total consideration of \$2,574,500 (an independent appraisal indicated a fair market value of \$2,632,000) in October of 2000 and April of 2001. TNC sold the larger portion of the property, subject to the conservation easement, for \$1,062,000 to the conservation buyer. No charitable pledge was made by the buyer. The buyer made a \$650,000 gift, in cash, to TNC within two weeks after closing. Project costs were also covered by additional private fundraising, although fundraising is not complete and there is still an outstanding project debt of \$417,000.
 - **Transaction Category:** I with a gift of cash

6. **Other Conservation Purposes Served:** A smaller portion (24.8 acres) of the two parcels originally acquired (the balance of the land not sold to the conservation buyer) was sold to an independent not-for profit Christian camp for \$200,000, its appraised FMV, in December of 2002, subject to conservation restrictions.

7. **How would possible changes in TNC conservation buyer policy have changed the transaction?**
Possible restrictions on sales to former Trustees.

Lake Huron, Mackinac County, Michigan (Jerrold Jung trust)

Observations

1. Jung cash contribution of \$650,000 and donative intent. Jung was quoted as saying that “[s]ince it was never my intent to develop the property anyway, it’s a real ‘no-brainer’ for me.”⁸¹ TNC’s internal e-mails and May 6, 2003, memorandum to the file (Gail Lewellan, TNC attorney) question donative intent.⁸² The Staff notes that this may be a transaction where donative intent is not present. The Staff also notes that it did not find a charitable pledge agreement similar to those TNC executed for other CBP transactions that might detail what portion of payments should be classified as purchase versus a charitable contribution. However, TNC did provide Jung with a letter of acknowledgement of receipt.

2. Chi-Mac charitable contribution. Chi-Mac provided TNC with a Form 8283 reporting that it was claiming a charitable contribution deduction of \$98,700 with respect to a bargain sale of the property to TNC (\$1,091,200 appraised value less \$992,500 received by the partnership from TNC). TNC accepted these even though it had stated internally that Chi-Mac had no donative intent.

3. Harmon charitable contribution. Harmon was paid \$100,000 for each property to assign his rights to the purchase agreements to TNC. Harmon took title to the Shillingburg tract and then deeded that property to TNC. Harmon apparently was never in the chain of title with respect to the Chi-Mac tract, which might affect his ability to claim a charitable contribution deduction for the “bargain sale” element of the transaction. Because TNC did not provide Forms 8283 or 8282 with respect to Harmon for either the Shillingburg or Chi-Mac tracts, the Staff could not determine whether Harmon claimed a charitable contribution deduction with respect to either of these properties. The assignment documents relating to Chi-Mac and Shillingburg between Harmon and TNC acknowledged Harmon’s intentions with respect to the excess of FMV over consideration to be a charitable contribution, and TNC’s agreement to treat such excess as a gift.⁸³

4. Shillingburg charitable contribution. TNC’s letter dated March 7, 2001, included a blank Form 8283 and stated the property transaction was a bargain sale. There is no record of Shillingburg providing TNC a signed Form 8283 or claiming a deduction for any bargain sale component.

5. Charitable organization’s obligations with respect to donative intent. The Staff does not expect TNC or other charitable organizations to discern donative intent. However, it questions whether it is appropriate for charitable organizations in general to provide acknowledgements that a gift was made when an organization itself questions donative intent in a particular instance.

⁸¹ “You can save the land, money too,” Observer & Eccentric of Real Estate, by Melissa Soule, Special Writer; “Wanted: Conservation Buyers,” The Nature Conservancy, Michigan Chapter.

⁸² See Appendix P for copy of memo.

⁸³ See *infra* footnote.

(a) Background

During August 2000, the Michigan chapter of TNC began to work on the acquisition of two adjacent tracts, one the Shillingburg tract (approximately 131 acres) and the other the Chi-Mac tract (approximately 81 acres), located on the northern shoreline of Lake Huron. These tracts were under purchase agreements between their respective owners and a real estate developer named Larry Harmon. Harmon indicated that he planned a development of 27 condominiums and a golf course with respect to the two tracts.⁸⁴ TNC identified these properties as having conservation value because they contained significant undeveloped shoreline for migratory and breeding birds and populations of the federally-threatened Houghton's goldenrod.⁸⁵ TNC ultimately acquired both of the tracts for disposition of a substantial portion of the property (approximately 185 acres) to a conservation buyer, Jerrold Jung. Mr. Jung was a former trustee of the TNC Michigan chapter.⁸⁶

TNC incurred acquisition and transaction costs of \$2,584,500 with respect to the Shillingburg and Chi-Mac tracts.⁸⁷ TNC financed the acquisitions by selling a substantial portion of the acquired properties to Jung, and obtaining cash contributions from Jung and others.⁸⁸ TNC acquired the Shillingburg tract in October 2000, and the Chi-Mac tract in April 2001.

In December 2002, TNC transferred to the Jerrold M. Jung Trust approximately 185 acres and received approximately \$1.7 million from the trust. The transferred land included almost all of the Shillingburg tract, and a significant portion of the Chi-Mac tract.⁸⁹ As part of

⁸⁴ Northern Lake Huron Bush Bay Shoreline Project Financial Summary, June 3, 2003, *see* Appendix P. The developer (Harmon) provided TNC with copies of his development plan for the condominiums and golf course, which was scheduled to go before the local planning commission on September 12, 2000, to secure local support. Planning commission approval was not required for the developer's plan. Action Item description for TNC Michigan Chapter Board of Trustees, October 6, 2000, p. 51; Memorandum dated May 15, 2003, from Diane Ray to file regarding Purchase of Chi-Mac and Shillingburg/Sale to Jung.

⁸⁵ TNC Project Approval Package Report for Huron (Chi-Mac Associates Limited Partnership), January 19, 2001; Action Item description for TNC Michigan Chapter Board of Trustees, October 6, 2000, p. 51.

⁸⁶ An April 2, 2001, email from Pat Bray to Jeffrey Knoop [both of TNC] describes Jung as "[a] friend and former trustee."

⁸⁷ This consisted of \$1,109,500 for Chi-Mac and \$1,475,000 for Shillingburg. Email dated April 9, 2001, from Bill McCort to Jeff Knoop, *see* Appendix O. This email suggested the amount paid for Shillingburg might be \$100,000 greater because of the assignment fee paid to Harmon, but this proved to be incorrect. A May 6, 2003, email from Diane Ray to Gail Lewellan states that the total cost to TNC was \$2,574,500 (\$1,099,500 for Chi-Mac and \$1,475,000 for Shillingburg), including the consideration paid to Harmon for assignment of the purchase agreements. The May 2003 amount does not include an additional \$450 paid by TNC to the seller for an appraisal update, or an additional \$9,550 paid by TNC to the seller's realtor to resolve a commission dispute between the realtor and the seller. Email dated May 6, 2003, from Diane Ray to Gail Lewellan, *see* Appendix P.

⁸⁸ Northern Lake Huron Bush Bay Shoreline Project Financial Summary, June 3, 2003.

⁸⁹ A memorandum dated July 29, 2003, from Diane Ray to Mike Dennis described that survey adjustments were made following the sales and that the 24.8 acres sold to Cedar Campus was about two-thirds from Shillingburg and one-third from Chi-Mac, and that the remaining 184.5 acres were sold to Jung.

the transfer, the trust conveyed a conservation easement to TNC. The conservation easement permitted Jung to construct a residence of up to 8,000 square feet on the property, to replace the existing 2,320 square feet home that was situated on the property. The transaction documentation referred to the transfer as part sale (consideration of \$1,062,000) and part contribution. TNC reported its purchase price for the portion of the property transferred to Jung as \$2,277,730.⁹⁰ An appraisal of 184.5 acres sold to Jung valued the acreage at \$2,298,000 (unrestricted) and the value of the property as restricted at \$1,062,000.⁹¹ TNC sold the remaining acreage (24.8 acres) to Inter-Varsity Ministries, a nonprofit known locally as Cedar Campus, in December 2002 for \$200,000.⁹²

TNC obtained its own appraisals that supported the purchase prices ultimately paid by TNC. TNC's appraisals were substantially less than those obtained by the developer, Mr. Harmon, but greater than the estimate of TNC's review appraiser and the appraisal ultimately obtained for the Jung transaction.⁹³ The combination of the \$2.3 million value of the property acquired by Jung and the \$0.2 million paid by Cedar Campus equaled \$2.5 million, slightly less than the \$2.6 million appraised amount of the Shillingburg and Chi-Mac tracts combined.⁹⁴ TNC's acquisition of each of the Shillingburg tract and the Chi-Mac tract was approved by TNC's state, division, and home office personnel.⁹⁵ The TNC Board of Governors approved the sale to Jung by resolution dated November 27, 2002.⁹⁶

According to TNC document submissions, the only Form 8283 filed with respect to these property transactions pertained to Chi-Mac Associates Limited Partnership, as more fully described below.

⁹⁰ Question 1 Response.

⁹¹ Memorandum dated May 6, 2002, from Densie Copen to file.

⁹² Memorandum dated November 5, 2001, from Jeff Knoop to Diane Ray; Northern Lake Huron Bush Bay Shoreline Project Financial Summary, June 3, 2003; Memorandum to file dated May 6, 2003, from Densie Copen regarding purchase of Chi-Mac and Shillingburg/sale to Jung, *see* Appendix P.

⁹³ TNC obtained appraisals of the properties from Steigerwaldt Land Services, Inc., for an appraisal fee of \$9,200. Invoice of Steigerwaldt Land Services, Inc. dated January 5, 2001. TNC paid the firm an additional fee of \$450 to update the appraisal in [May] 2001. The combined appraisals came in at \$2.5 million. Lloyd Kirby, TNC's review appraiser, estimated the combined values to be in the \$1.9 to \$2 million range. Memorandum to File from Diane B. Ray dated September 29, 2000, *see* Appendix P.

⁹⁴ TNC's appraiser appraised the Chi-Mac tract at \$1,054,500 and the Shillingburg tract at \$1,578,000, as of August 30, 2000.

⁹⁵ Real Estate Project Division/Home Office/BOG Approval, Midwest and Great Plains Divisions, Home Office Approval dated September 25, 2000. The project was approved by Bill Weeks in his capacity as acting president on September 25, 2000. Email from George Spicer to various TNC personnel dated September 25, 2000. The Executive Committee of the Michigan chapter approved the acquisitions of the two tracts on September 6, 2000. Action Item description for TNC Michigan Chapter Board of Trustees, October 6, 2000, p. 51.

⁹⁶ Certificate of Dianne Masters, Assistant Secretary, dated November 27, 2002, regarding Northern Lake Huron Chi-Mac and Shillingburg Tracts Mackinac County, Michigan.

(b) Description of the parcels

The Shillingburg and Chi-Mac parcels were adjacent to each other and were located on the Lake Huron northern shoreline. The Shillingburg tract consisted of 131.5 acres and approximately 2,200 feet of shoreline.⁹⁷ The Shillingburg tract had a small cabin on the property.⁹⁸ The Chi-Mac property consisted of 81.39 acres and approximately 1,600 feet of frontage along Lake Huron.⁹⁹ The Chi-Mac tract also included a house, garage, pole barn, and crib dock.¹⁰⁰

To the west of the Shillingburg and Chi-Mac parcels were 330 acres of shoreline property owned by a private business. To the east of the properties were 360 acres of shoreline owned by a nonprofit organization, Cedar Campus.¹⁰¹ TNC described the area as one of the “richest and most productive biological areas in the country,” and identified the site as a priority area for biodiversity in its report, “Conservation of Biological Diversity.”¹⁰²

(c) Harmon’s development plan and role in the transactions

Larry Harmon, a local real estate developer, had executed purchase agreements in August 2000 to acquire the Shillingburg and Chi-Mac tracts from their respective owners. Harmon executed the Chi-Mac tract purchase agreement on August 19, 2000. This agreement obligated Harmon to purchase the Chi-Mac tract for \$992,500, and was accepted by the Chi-Mac partnership on August 21, 2000.¹⁰³ Harmon executed the Shillingburg purchase agreement on August 29, 2000. This agreement obligated Harmon to purchase the Shillingburg tract for \$1,375,000.¹⁰⁴ Thus, Harmon had the right to acquire both tracts for a combined purchase price of \$2,367,500.¹⁰⁵

Harmon intended to develop the Shillingburg and Chi-Mac tracts as condominiums (27 condominiums with an average lot size of 2.85 acres, plus 24 additional condominiums of much smaller lot sizes) and a golf course. Harmon obtained an appraisal of the Shillingburg and Chi-

⁹⁷ Action Item description for TNC Michigan Chapter Board of Trustees, October 6, 2000, p. 51.

⁹⁸ Action Item description for TNC Michigan Chapter Board of Trustees, October 6, 2000, p. 51.

⁹⁹ Action Item description for TNC Michigan Chapter Board of Trustees, October 6, 2000, p. 51.

¹⁰⁰ TNC Closing Memorandum dated April 30, 2001, from Rose Anne Roznowski to Helen Taylor.

¹⁰¹ Action Item description for TNC Michigan Chapter Board of Trustees, October 6, 2000, p. 51.

¹⁰² Northern Lake Huron (Chi-Mac Associates Limited Partnership) Project Approval Package Report, January 19, 2001.

¹⁰³ TNC ultimately acquired this property for total costs of \$1,109,500.

¹⁰⁴ TNC ultimately acquired this property for total costs of \$1,475,000.

¹⁰⁵ Appraisal of Carol Peterson dated September 24, 2000.

Mac tracts on September 24, 2000, which determined the “as is” fair market value of the two tracts as of August 31, 2000, to be \$3.852 million.¹⁰⁶

Throughout August and September 2000, TNC discussed the properties and his development plans with Harmon, and by late September 2000, TNC reached a tentative deal with Harmon to acquire the properties from him for \$200,000 more than his combined purchase price of \$2,367,500.¹⁰⁷

On September 27, 2000, Chi-Mac partnership notified Harmon that it did not wish to proceed with the sale to Harmon, primarily because Harmon was not proceeding satisfactorily with respect to the partnership’s wishes that the property be preserved in its natural state by TNC.¹⁰⁸ Shortly thereafter Harmon and Chi-Mac Partnership became involved in litigation regarding the Chi-Mac purchase agreement. Harmon filed a summons and complaint in Mackinac County court of October 14, 2000, seeking damages and specific performance of the purchase agreement. A settlement agreement between the parties resulted in dismissal of Harmon’s lawsuit against the partnership in exchange for the partnership’s consent to the assignment of Harmon’s rights under the purchase agreement to TNC.¹⁰⁹ The settlement agreement obligated TNC to protect the property for conservation purposes through a transfer to a conservation buyer, and the conveyance of a conservation easement with respect to the tract to TNC.

The documentation provided by TNC does not indicate whether Harmon claimed a charitable contribution deduction with respect to either of the Chi-Mac or Shillingburg properties.

(d) TNC’s acquisition of Shillingburg tract

TNC acquired the 131.50 acre Shillingburg tract on October 30, 2000, for \$1,475,000.¹¹⁰ There were improvements on the property - a cabin and a shack.¹¹¹ The acquisition was effected

¹⁰⁶ Summary Appraisal of Real Property as of August 31, 2000, by Carol A. Peterson. Peterson projected the value of the properties under Harmon’s proposed development to be \$6 million, with roads and site improvements. Peterson previously had appraised the properties separately, determining the value of the Chi-Mac tract to be \$1,210,000 (report dated September 13, 2000), and the value of the Shillingburg tract to be \$1,700,000 (report dated September 13, 2000). TNC’s review appraiser later determined that Harmon’s appraiser, though licensed, was not certified, and thus could not do appraisals of that magnitude, and that the methodology used by the appraiser was suspect. Memorandum to File from Diane B. Ray dated September 29, 2000.

¹⁰⁷ Email dated September 29, 2000, from Bill McCort to Diane Ray, *see* Appendix P.

¹⁰⁸ Letter dated September 27, 2000, from Mark K. Wilson to Sally J. Brumleve of Brumleve Properties.

¹⁰⁹ This apparently had the effect of terminating the earlier assignment and acceptance executed by TNC and Harmon in September 2000.

¹¹⁰ This included a payment of \$100,000 to Larry Harmon for his assignment of the purchase agreement to TNC. Harmon also was reimbursed his \$50,000 earnest money.

¹¹¹ Memorandum dated October 19, 2000, from Bill McCort to Helen Taylor, State Director, MIFO. “MIFO” stands for Michigan Field Organization.

through an assignment by Harmon of his rights, interests, and obligations with respect to the purchase agreement to TNC, and deeds of the property from the Shillingburgs to Harmon, and then from Harmon to TNC.

TNC had been aware that Harmon was attempting to acquire the Shillingburg tract. On August 22, 2000, William McCort of TNC sent Brumleve Properties, the listing agent, a letter stating that TNC was interested in buying the Shillingburg property.¹¹²

On August 28, 2000, TNC engaged the services of Steigerwaldt Land Services, Inc. to conduct an appraisal of the Shillingburg tract. The firm completed the appraisal as of August 30, 2000, and in an undated appraisal report, determined the value of the property to be \$1,578,000, based on its highest and best use as a development of seasonal residential lots.¹¹³

The Michigan chapter obtained state, division, and home office approvals by September 25, 2000, with respect to the Shillingburg acquisition for a purchase price not to exceed \$1,679,500.

Harmon had executed the Shillingburg purchase agreement on August 29, 2000, to purchase the Shillingburg tract for \$1,375,000. An Assignment of Real Property Interest, Agreement to Quit Claim, and Acceptance of Assignment was executed by Harmon on October 6, 2000, and by TNC on October 10, 2000, pursuant to which Harmon assigned his rights and interests in the purchase agreement to TNC in exchange for \$100,000.¹¹⁴ The parties acknowledged that the fair market value of the property may substantially exceed the purchase price established by the purchase agreement and the additional consideration paid for the assignment, and that any excess “is intended by Harmon as a charitable contribution to the Conservancy and will be treated by the Conservancy as such a gift.”¹¹⁵

A warranty deed dated October 18, 2000, with Larry Harmon as the grantor and TNC as the grantee, granted the right to make all divisions under section 108 of the land division act in exchange for the sum of \$100,000.¹¹⁶

In a letter from TNC to Harmon dated March 7, 2001, TNC described the acquisition as a bargain sale purchase for consideration of \$1.475 million from the Harmons that closed on

¹¹² Letter dated August 22, 2000, from William D. McCort to Ms. Sally Brumleve of Brumleve Properties.

¹¹³ A Real Estate Appraisal 131.5 Acres of the Shillingburg Property with 2,200 Feet of Frontage on Lake Huron Mackinac County, Michigan, August 30, 2000.

¹¹⁴ TNC files show an earlier assignment dated September 12, 2000, was null and void for failure by one of the parties to remove a contingency. An October 2, 2000, email from Bill McCort to Diane Ray, states that Harmon planned to treat the \$200,000 (\$100,000 for each of the two properties) assignment fees as if it all related to Shillingburg, not equally between the two tracts. *See* Appendix P.

¹¹⁵ Assignment of Real Property Interest, Agreement to Quit Claim, and Acceptance of Assignment, between Harmon and TNC.

¹¹⁶ Warranty deed dated October 18, 2000. It is unclear why the warranty deed recites a consideration of \$100,000, the amount of the assignment consideration, rather than for the entire purchase price.

October 13, 2000.¹¹⁷ In that letter, TNC advised the Harmons that they needed to complete and return to TNC a Form 8283 if the Harmons intended to take a charitable contribution deduction with respect to a gift of the land in excess of \$500, and enclosed a copy of Form 8283 for completion by the Harmons. The documentation provided by TNC does not indicate that the Harmons provided a Form 8283 with respect to the Shillingburg tract, or that they claimed a charitable contribution deduction with respect to that tract.

(e) TNC's acquisition of Chi-Mac tract

TNC had been aware that Harmon was attempting to acquire the Chi-Mac tract. On August 22, 2000, William McCort of TNC sent Brumleve Properties, the listing agent, a letter with a draft of a right of first refusal regarding the Chi-Mac tract.¹¹⁸ The right of first refusal would have given TNC a right to acquire the Chi-Mac tract from the partnership for \$992,500 for a one-year period if the partnership received a bona fide offer with respect to the property.

On August 28, 2000, TNC engaged the services of Steigerwaldt Land Services, Inc. to conduct an appraisal of the Chi-Mac tract. The firm completed the appraisal as of August 30, 2000, and in an undated appraisal report, determined the value of the property to be \$1,054,500, based on its highest and best use as a development of seasonal residential lots.¹¹⁹

TNC negotiated with Harmon to attempt to purchase the Chi-Mac tract from Harmon. Harmon and TNC executed an Assignment of Real Estate Sales Contract and Acceptance of Assignment with respect to Harmon's purchase agreement for the Chi-Mac tract on September 11, 2000, and September 12, 2000, respectively. The assignment provided that TNC would pay Harmon \$147,000 as consideration for the assignment and reimburse Harmon the earnest money consideration Harmon had paid. The parties acknowledged that the fair market value of the property may substantially exceed the purchase price established by the purchase agreement and the additional consideration paid for the assignment, and that any excess "is intended by Harmon as a charitable contribution to the Conservancy and will be treated by the Conservancy as such a gift."¹²⁰

The Michigan chapter obtained state, division, and home office approvals by September 25, 2000, with respect to the Chi-Mac acquisition for a purchase price not to exceed \$1,213,000.

¹¹⁷ TNC letter dated March 7, 2001, to Larry D. and Sandra Harmon. This letter was intended to serve as TNC's written substantiation of the gift from the Harmons to TNC. The letter made no statement about the value of the gift, and stated that TNC does not play a role in determining the value of the gift.

¹¹⁸ Letter dated August 22, 2000, from William D. McCort to Ms. Sally Brumleve of Brumleve Properties.

¹¹⁹ A Real Estate Appraisal 81.39 Acres of the Connolly Property with 1,800 Feet of Frontage on Lake Huron Mackinac County, Michigan, August 30, 2000. The Chi-Mac property was also referred to as the Connolly property because one of the partnership's partners was a Connolly and the property had been held by the Paul Connolly Estate.

¹²⁰ Assignment of Real Estate Sales Contract and Acceptance of Assignment, between Harmon and TNC.

On September 27, 2000, Chi-Mac partnership notified Harmon that it did not wish to proceed with the sale to Harmon, primarily because Harmon was not proceeding satisfactorily with respect to the partnership's wishes that the property be preserved in its natural state by TNC.¹²¹ Shortly thereafter Harmon and Chi-Mac Partnership became involved in litigation regarding the Chi-Mac purchase agreement. Harmon filed a summons and complaint in Mackinac County Court on October 14, 2000, seeking damages and specific performance of the purchase agreement.

Internal TNC file documents indicate that TNC had identified its conservation buyer with respect to the Chi-Mac tract at least by October 3, 2000.¹²² A TNC letter of the same date from Helen Taylor to Mark Wilson of the Chi-Mac partnership informs Wilson of this fact and states that TNC will place a conservation easement on the property upon acquisition of the property from Chi-Mac. TNC's letter to Wilson states that although conservation easements "greatly lower the value of the property (up to 70 percent lower is not uncommon)," TNC's "conservation buyer is willing to give [TNC] \$1,000,000 for the property with the conservation easement in place." TNC stated that it would hold the conservation easement and monitor it to make sure it is upheld.

A November 20, 2000, internal TNC email indicates that TNC was having conservation easement charitable contribution discussions with the seller of the Chi-Mac tract.¹²³

On January 23, 2001, TNC mailed Harmon a draft purchase agreement pursuant to which TNC would acquire from Harmon for a purchase price of \$1,092,500 the Chi-Mac tract after he acquired it from the current owner.¹²⁴ Notes to TNC's files indicate that Harmon requested that TNC pay Harmon's legal fees with respect to the Chi-Mac litigation, but that TNC stated that TNC could "not pay his legal fees directly (nor can another non-profit)."¹²⁵

After extensive settlement negotiations pertaining to the Chi-Mac Partnership/Harmon litigation, a settlement agreement between the Chi-Mac partnership, Harmon, and TNC resulted in dismissal of Harmon's lawsuit against the partnership in exchange for the partnership's consent to the assignment of Harmon's rights under the purchase agreement to TNC.¹²⁶ The settlement agreement obligated TNC to protect the property for conservation purposes through a

¹²¹ Letter dated September 27, 2000, from Mark K. Wilson to Sally J. Brumleve of Brumleve Properties.

¹²² Email dated October 3, 2000, from Diane Ray to Bill McCort (describing that a conservation buyer is not "paying" unrestricted fair market value for the restricted property, but rather is "buying the property for its (reduced) fair market value, then making a donation of the rest."). See Appendix P.

¹²³ Email from Diane Ray to Bill McCort dated November 20, 2000, acknowledging Wilson's questions regarding how deductions may be taken for value decreases attributable to conservation restrictions. See Appendix P.

¹²⁴ Letter dated January 23, 2001, from William D. McCort to Larry Harmon.

¹²⁵ Notes to TNC's files dated February 22, 2001.

¹²⁶ This apparently had the effect of terminating the earlier assignment and acceptance executed by TNC and Harmon in September 2000.

transfer to a conservation buyer, and the conveyance of a conservation easement with respect to the tract to TNC. As a part of the settlement, Chi-Mac Associates Limited Partnership executed a Consent of Seller to Assignment of Sales Contract on March 21, 2001.¹²⁷ This consent recited that TNC intended to ensure preservation of the property's natural features by placement of a conservation easement on the property that will bind future landowners, restrict uses of the property, and prohibit development on the property beyond its present state. On March 22, 2001, Harmon sent a letter to the real estate listing agent stating that TNC had assumed his contract to purchase the Chi-Mac tract from the Chi-Mac Partnership, and that TNC would be reimbursing Harmon \$50,000 for his earnest money being held by the agent.¹²⁸ Harmon and TNC executed the Assignment of Real Estate Sales Contract and Acceptance of Assignment on March 23, 2001.¹²⁹ Under the agreement, Harmon would receive \$107,000 as consideration to assign the purchase agreement rights to TNC.

A March 23, 2001, internal TNC email discusses the possibility of Chi-Mac taking a charitable contribution deduction with respect to the partnership's sale of the property to TNC, and states "[a]s I told [Chi-Mac] when we spoke (before the letter was drafted), we can provide them with a copy of our appraisal but they'll need their own (and need to pay for it) if they plan to take a charitable deduction. Also, I told him I didn't think there was any donative intent and that they would be asking for trouble if they do try to take this as a deduction."¹³⁰

TNC acquired the Chi-Mac tract from the Chi-Mac Associates Ltd. Partnership on April 6, 2001, for \$1,099,500.¹³¹ In addition, TNC paid \$9,550 to the seller's listing agent to resolve a dispute between the seller and the agent regarding her commission.¹³² The warranty deed dated April 5, 2001, from Chi-Mac Associates Limited Partnership directly to TNC reported the consideration as \$992,500 for real estate transfer tax purposes.

Chi-Mac Associates Limited Partnership provided TNC with a page 2 of Form 8283, on October 11, 2002. This form reported the appraised fair market value of the Chi-Mac property as \$1,091,200; the donor's cost or adjusted basis as \$208,486; the amount received by the partnership pursuant to a bargain sale as \$992,500; and the amount claimed as a deduction as \$98,700. The form also reported that TNC received the donated property on April 6, 2001. TNC

¹²⁷ Consent of Seller to Assignment of Sales Contract by Chi-Mac Associates Limited Partnership dated March 21, 2001.

¹²⁸ Letter from Larry Harmon to Sally Brumleve dated March 22, 2001.

¹²⁹ Assignment of Real Estate Sales Contract and Acceptance of Assignment between Larry Harmon and TNC dated March 23, 2001.

¹³⁰ Email dated March 23, 2001, from Diane Ray to Bill McCort regarding Chi-Mac, *see* Appendix O. Ray repeated her belief there was no donative intent in an April 4, 2001, email to Bill McCort ("I just don't see why we should pay for an updated appraisal when we don't even think there's donative intent."). *See* Appendix P.

¹³¹ Settlement Statement dated April 6, 2001. This included a payment of \$107,000 to Larry Harmon for the assignment of the purchase agreement to TNC, and \$992,500 to the partnership as purchase price.

¹³² Letter dated April 6, 2001, from Diane B. Ray to Sally Brumleve of ERA Brumleve Properties, Inc., agreed to by Brumleve on the same date, *see* Appendix P.

files indicate approval of the form as provided by Chi-Mac, and that TNC signed the form.¹³³ TNC subsequently provided the partnership with a Form 8282 notifying the partnership that TNC had acquired the property from the partnership in a bargain sale transaction, and disposed of the donated property on December 13, 2002. Thus, TNC signed these forms even though its earlier internal correspondence documented that TNC believed there was no donative intent on the part of Chi-Mac, and Chi-Mac “would be asking for trouble if they do try to take this as a deduction.”

(f) TNC negotiations with Jung, the conservation buyer

During the summer of 2000, Helen Taylor of the Michigan chapter “made several phone calls to current trustees to determine if they or anyone they knew would be interested in being a conservation buyer for the [Shillingburg and Chi-Mac] parcels.”¹³⁴ Jung, a former Michigan chapter trustee, emerged from this inquiry as the only person as a potential conservation buyer.¹³⁵ In an August 23, 2000, memorandum from Bill McCort to Jerry Jung, TNC informed Jung that the Shillingburg property, 120 acres with 2,150 feet of frontage on Lake Huron, was up for sale and suggested that Jung “might be interested in making an offer” for the property.¹³⁶

TNC records state that TNC made no other attempts to market the property.¹³⁷ On January 17, 2001, Mr. Shillingburg contacted TNC asking whether TNC would be willing to sell the Shillingburg property back to him with deed restrictions, but there is no indication that TNC ever contacted Shillingburg regarding this possibility.¹³⁸

Internal TNC correspondence dated September 25, 2000, indicates that Jung had committed to providing \$1 million to TNC for the Lake Huron properties, and that TNC would “secure the properties, carve off the Chi-Mac property, place development restrictions on it, modify the boundaries a bit, and transfer it to Jung.”¹³⁹

An October 3, 2000, email from Bill McCort to Diane Ray evidences that TNC had conversations with Jung by this time about which property, the Chi-Mac or Shillingburg tract,

¹³³ TNC copy of Mark Wilson fax dated October 11, 2002, to Diane Ray of TNC regarding page 2 of Form 8283 regarding bargain sale of the Chi-Mac tract (“OK-fax back to Mark Wilson”). There is no indication that TNC notified Chi-Mac that TNC’s appraised value of the Chi-Mac tract was approximately \$50,000 less than that reported as the appraised fair market value by Chi-Mac on the Form 8283.

¹³⁴ Memorandum dated May 15, 2003, from Diane Ray to file.

¹³⁵ Memorandum dated May 15, 2003, from Diane Ray to file.

¹³⁶ Memorandum dated August 23, 2000, from Bill McCort to Jerry Jung.

¹³⁷ Conservation Buyer Transaction Summary (“No further marketing was done on the tracts.”); Email dated May 8, 2003 from Jeff Knoop to Diane B. Ray (“the property was never listed for sale to the general public after it was acquired by TNC.”).

¹³⁸ Email from Bill McCort to “jknoop” and “dray” of TNC dated February 15, 2002.

¹³⁹ Email dated September 25, 2000, from Helen Taylor to Diane Ray.

would better suit Jung's needs with respect to a residence, and that the Chi-Mac tract was better suited for Jung because the Shillingburg property had the smaller residence on it and would require more development and improvement.

In an October 5, 2000 fax from McCort to Brumleve, McCort states that TNC intends to "place a conservation easement on the property and then sell it to a conservation buyer who we have already identified."

An April 2, 2001, email from Bray to Knoop describes the potential sale to Jung. The email states that Jung is willing to buy "whatever property he can" of the two pieces for a "total commitment of \$1.7 million." Bray states that it is TNC's "goal to get out of the project without having to do anymore fund raising while covering our costs. If the value is equal to or lower than \$1.7 million we would want to sell it all to Jerry. If it's lower we hope Jerry will donate the difference."

On May 17, 2001, TNC notified Chi-Mac that the conservation buyer with respect to the Chi-Mac tract is Jerry Jung.¹⁴⁰

The negotiations between Jung and TNC included discussions regarding the conservation easement (e.g., pond and ditch restoration, ATV and snowmobile use, garden use and flower beds, preventing motorized access to the property, timber cutting, and the size of the residence that could be built on the property).¹⁴¹ Jung suggested that the square footage of the residence not exceed 8,000 square feet.¹⁴² Jung also advised TNC that he had "reserved \$1,700,000 to purchase the property with easement. I'd prefer to purchase the property for as little as possible and make a charitable contribution of the balance. We will see what the appraisal says."¹⁴³

TNC and Jung had further discussions regarding Jung's charitable contribution deduction. TNC records indicate that on or about October 25, 2001, Jung had asked TNC the following question: "Would there be any advantage having TNC buy the easement with a donation that I made to the Conservancy? For instance, what if I write two checks to the Conservancy -- one for \$1,500,000 to purchase the property and one for \$1,200,000 as a donation. TNC would then purchase the easement for \$1,000,000. This provides the same net proceeds of \$1,700,000 to TNC. It would also better document the transaction for tax purposes."¹⁴⁴ On December 21, 2001, TNC wrote Jung that "the best, and cleanest, way to

¹⁴⁰ Email from Bill McCort to "crufone" dated May 17, 2001, *see* Appendix P.

¹⁴¹ Emails between Jung and Jeff Knoop, September 2001, *see* Appendix P.

¹⁴² Email from Jerry Jung to Jeff Knoop dated September 21, 2001, *see* Appendix P.

¹⁴³ Emails between Jung and Jeff Knoop dated September 2001, *see* Appendix P.

¹⁴⁴ Email dated October 25, 2001, from Jeff Knoop to [Diane Ray], *see* Appendix P.

structure this deal is for you to acquire the property at full market value subject to the easement. The difference up to the \$1.7M can be made as a cash contribution for income tax purposes.”¹⁴⁵

In a letter dated February 7, 2002, Jung’s counsel advised Jung that the [draft] purchase agreement prevented Jung from ever being able to “split the land” and that “the imposition of the conservation easement may well have a major negative impact on the value of the land should you decide to sell it at some point in the future.”¹⁴⁶

The purchase agreement between the Jerrold M. Jung Trust UTA as buyer, and TNC as seller, was executed by the parties on February 28, 2002, and March 1, 2002, respectively. The agreement provided for the acquisition by the Jung trust of 185.459 acres for a purchase price of \$1,062,000. As a condition of closing, the Jung trust was to execute and deliver to TNC at closing a conservation easement in the form attached to the agreement. The conservation easement was to be recorded prior to any mortgage or other security interest that secured the buyer’s repayment of any loan obtained in relation to the buyer’s purchase of the property. The agreement conveyed to the buyer the right to make zero division splits under the Michigan Land Division Act. The form of the conservation easement granted TNC a conservation easement in perpetuity over the property, including, among other things, the following terms: (1) a restriction against industrial, commercial, agricultural, or commercial recreational activity; (2) no construction or placing of any house, garage, barn or other building, and other listed structures, except that existing structures may be maintained, improved, replaced or removed as specified elsewhere in the easement; (3) the property may not be divided, partitioned, subdivided, or conveyed except in its current configuration as an entity; and (4) no mining, drilling, exploring for, or removal of minerals from the property was permitted. The buyer reserved the right to convey the property subject to the easement, and to use the personal residences, accessory buildings, and other improvements on the property at the time of the grant of the easement, consisting of the single story house, pole building, log cabin, and a cribbage boat deck. The buyer also retained the right to reconstruct or replace the house, so long as any replacement or expansion is located in substantially the same location as the main house at the time of the grant of the easement, and the footprint of the main house or replacement thereof does not exceed 8,000 square feet.¹⁴⁷ The log cabin could not be replaced, renovated, or restored.

In a May 21, 2002, letter from TNC to the seller of the Chi-Mac property, McCort (as TNC’s Director of Protection) notified Connolly that he could not remove some saplings from the property because it was not allowing any cutting until it completed its conservation easement and identified the stewardship needs of the property.

¹⁴⁵ Email dated December 21, 2001, from Jeff Knoop to Jerry Jung. This is consistent with an email from Diane Ray to Jeff Knoop dated November 14, 2001 (“I agree with you that the ‘cleanest’ way for the donation to be handled is to have him pay FMV for the property (with the easement in place), then have him give a cash donation of the remainder.”).

¹⁴⁶ Letter from D. Douglas Alexander to Jerrold M. Jung dated February 7, 2002.

¹⁴⁷ The footprint square footage of the existing single story house was 2,320 square feet. Exhibit C to Conservation Easement dated December 9, 2002.

TNC kept Jung apprised of difficulties it was experiencing regarding the land acquisitions. On August 6, 2002, Jung told TNC that he would “be happy to make a similar commitment (\$1,700,000) on another parcel if this one falls through.”¹⁴⁸

Certain TNC records indicate that Jung “never made any kind of formal pledge, written or unwritten, in conjunction with the transaction.”¹⁴⁹ These records are inconsistent with other TNC records, however, that acknowledge that TNC and Jung discussed structuring the transaction to split Jung’s \$1.7 million commitment as purchase price (to the extent of the property’s restricted value) and a cash contribution for the remainder.¹⁵⁰

(g) TNC’s transfer of real property to Jung for cash and conservation easement

The sale to Jung closed on December 13, 2002.¹⁵¹ According to the settlement statement, Jung paid \$1,062,000 to TNC for the property. The warranty deed, dated November 18, 2002, conveyed the property from TNC to the Jerrold M. Jung Trust UTA and reported full consideration as \$1,057,000. The conservation easement, dated December 9, 2002, was consistent with the form of easement attached to the executed purchase agreement.¹⁵²

Internal TNC accounting documents dated December 16, 2002, report the acquisition of the conservation easement with respect to the 188.09 acres as having a fair market value of \$1,312,500.¹⁵³ Internal TNC documents of the same date report the transfer out of 56.59 acres of the Chi-Mac tract and all 131.50 acres of the Shillingburg tract for \$1,062,000.

TNC obtained an appraisal of the conservation easement granted by Jung to TNC on the 184.5 acres. The appraisal report, dated January 22, 2002, valued the easement at \$1,236,500 as of January 1, 2002.¹⁵⁴ The appraiser concluded that the under the easement “the grantor gives up numerous rights including all potential income from forest management, the opportunity to

¹⁴⁸ Email dated August 6, 2002, from Jerry Jung to Helen Taylor.

¹⁴⁹ Memorandum dated May 15, 2003, from Diane Ray to file; Conservation Buyer Transaction Summary. See also TNC summary provided above regarding lack of pledge agreement.

¹⁵⁰ Email dated October 25, 2001, from Jeff Knoop to [Diane Ray]. Email dated December 21, 2001, from Jeff Knoop to Jerry Jung. This is consistent with an email from Diane Ray to Jeff Knoop dated November 14, 2001 (“I agree with you that the ‘cleanest’ way for the donation to be handled is to have him pay FMV for the property (with the easement in place), then have him give a cash donation of the remainder.”).

¹⁵¹ Closing Memorandum dated December 20, 2002, from Sue Corbin to Helen Taylor.

¹⁵² The conservation easement was accepted by TNC on November 18, 2002, although it was not executed by Jung on behalf of the Jung trust until December 9, 2002.

¹⁵³ Other internal TNC documents report the easement value as \$1,236,500, with the unrestricted property value being \$2,298,500 for the 184.5 acres acquired by Jung. Northern Lake Huron Bush Bay Shoreline Project Financial Summary, June 3, 2003.

¹⁵⁴ Complete Appraisal Summary Report, 184.5 Acres of The Nature Conservancy Property with 3,800 Feet of Frontage on Lake Huron Mackinac County, Michigan. The appraisal noted that the property field work and inspection occurred in August 2000.

divide the land into smaller parcels for future development (and income), and the right to hunt. It is our opinion that the easement substantially lowers the property value, not only for the current landowners, but in perpetuity, by restricting development, eliminating potential income from the sale of timber, and the prohibition of hunting which, in itself, is a significant ownership factor, or reason for buying and holding recreational land in the regional market.”¹⁵⁵ The appraiser concluded that the highest and best use of the property, but for the conservation restrictions, was as development property with resale of the property into smaller seasonal residential and recreational properties.¹⁵⁶ The highest and best unit of the property as restricted was as one large parcel of residential and recreational land. The conservation easement value was the difference between a “before” condition value of \$2,298,500, and an “after” condition value of \$1,062,000.¹⁵⁷

TNC provided a letter dated January 22, 2003, to Jung, acknowledging his gift of \$650,000 on December 30, 2000. A copy of Jung’s check in the amount of \$650,000, dated December 17, 2002, was included in TNC’s files. According to TNC records, Jung’s total contribution was the sum of the \$650,000 cash contribution and the \$1,236,500 value of the conservation easement.¹⁵⁸ TNC records indicate that it was Jung’s understanding that the funds were to be used “as the Michigan chapter saw fit.”¹⁵⁹ TNC reported that it did not obtain a Form 8283 with respect to the disposition of the property to the Jung trust.¹⁶⁰

IV. CBP Transaction – Shelter Island

TNC prepared the following summary of this transaction, also described in *The Washington Post*, for its June 13, 2003 Board of Governors meeting.

¹⁵⁵ Complete Appraisal Summary Report, at p. 19.

¹⁵⁶ Complete Appraisal Summary Report, at p. 20.

¹⁵⁷ Complete Appraisal Summary Report, at p. 34.

¹⁵⁸ Northern Lake Huron Bush Bay Shoreline Project Financial Summary, June 3, 2003. This would appear to suggest a contribution by Jung of approximately \$1.9 million, although no other documentation suggests a contribution of this magnitude.

¹⁵⁹ Email dated May 8, 2003, from Jeff Knoop to Diane B. Ray regarding Jung Sale - ChiMac.

¹⁶⁰ Question 1 Response (not applicable (no gift involved) on the TNC disposition).

CONSERVATION BUYER TRANSACTION SUMMARY—D

Site or Project Name: Thompson Hill Property, Mashomack Preserve, NY

Purchaser Name: James and Nancy Dougherty

Land: 9.38-acre parcel located immediately adjacent to and surrounded on two sides by TNC's Mashomack Preserve, on Shelter Island, NY. Another side of the property is bounded by Peconic Bay, one side is bounded by a road, and one side is bounded by another private landowner.

Date of Sale: 10/28/99

1. **Consistency with Conservation by Design:** Mashomack Preserve is long-standing (20 years) Conservancy Preserve and one which is included in the North Atlantic Coast Eco-regional plan as portfolio site. At the time of the original acquisition of the Mashomack property, the sellers, three brothers engaged in various real estate development activities withheld from the sale this parcel of land for possible resale or development. For many years thereafter, this parcel was sought after by TNC to complete the lands needed for protection and as a buffer for the Preserve.
 - **Threat:** The property could be easily subdivided into three residential development lots. Threats to be addressed include habitat fragmentation through further subdivision and habitat (sensitive coastal dunes and bluffs) destruction and water quality (adjacent tidal salt marsh and creek) degradation through sedimentation and erosion from inappropriately sited residential development.
 - **Conservation Easement:** Conservation easement terms provide for the property being permanently restricted to one residential dwelling and ancillary structures and require all but a small writer's cabin to be located within a surveyed development envelope placed well away from the bluffs and nearby creek.
2. **Valuation Substantiation:** TNC obtained independent appraisal of property setting FMV at \$2.0 Million based on highest and best use of a three lot residential subdivision as of 1/20/99 prior to TNC purchase of property. TNC obtained independent appraisal (from yet other appraiser) appraising conservation easement at \$1.594 Million and value of encumbered land at \$506,000.
3. **Marketing Efforts:** During negotiations for purchase of property, TNC sought potential buyers by word of mouth. Three Mashomack Trustees expressed interest in property. TNC established a written outline of the proposed conservation terms and conditions. The Doughertys expressed most willingness to abide by conservation terms and conditions. Considering the most likely way to avoid future problems with owners about the proposed conservation terms and conditions, TNC decided to sell the land to the Doughertys as people known to have a sincere conservation ethic. No other marketing efforts were undertaken.
4. **Buyer's Relationship to TNC:** Buyers are husband and wife; husband was a former trustee of the TNC's South Fork-Shelter Island Chapter (term of service from 1982 to 1994) and wife is current Trustee of Mashomack Preserve Advisory Board, having served since 1997 and was a Trustee when the transaction occurred.
5. **Structure of the Deal:** TNC purchased the property unrestricted from the original owners on 9/2/99 for \$2.1 Million. On 10/28/99, TNC signed the contract and transferred title to the land to new buyer for \$506,000, subject to conservation restrictions. At the closing on 10/28/99, the new buyer made a separate charitable pledge to donate \$1.652 Million over 15 months. The pledged amount was received by TNC from buyers in a series of stock donations within the required timeframe. No other private fundraising was sought or needed for this project.

- **Transaction Category:** I with a gift of stock
6. **Other Conservation Purposes Served:** aesthetic considerations to keep development away from the Preserve, native vegetation protected.
 7. **How would possible changes in TNC conservation buyer policy have changed the transaction?**
Greater restrictions on sales involving Trustees and possible wider marketing efforts.

Observations

1. Purchase and pledge agreements. The Staff notes the purchase agreement and the pledge agreement do not describe the entirety of the agreement of the parties. They do not indicate that both TNC and the Doughertys understood and agreed that the Doughertys were to pay \$2,152,000 to TNC, consisting of \$500,000 allocated to purchase price, and the remainder allocated to the charitable pledge. The Staff notes that the documentation indicates that TNC agreed to exclude from the legal documents certain critical terms at the request of the Doughertys to accommodate the Doughertys tax position in the event of IRS audit.

2. Tax planning for charitable contribution deduction. The Staff notes that that TNC engaged in substantial discussions with the Doughertys and their counsel regarding the ability of the Doughertys to claim a charitable deduction for the \$1.652 million amount paid pursuant to the Pledge Agreement, and regarding the structuring and documentation of the transactions for the Doughertys tax purposes.

Overview

The Shelter Island, New York CBP transaction involved the purchase and sale by TNC of unimproved real property at 21 Thompson Hill Road (“Thompson Hill”) on Shelter Island, New York, and the placement of conservation restrictions on the subject property. The property was acquired by TNC in September 1999 from the Gerard family (“Gerards”)¹⁶¹ and shortly thereafter sold by TNC to James and Nancy Dougherty (“Doughertys”). The 9.38 acre property, mostly wooded, abuts, on both its northerly and easterly side, the Mashomack Preserve, protected land owned by TNC.¹⁶² The property was vacant and unimproved when acquired and transferred by TNC. Shelter Island is primarily a summer community accessible only by ferry, private boats, or small planes.¹⁶³ There are no bridges providing road access to the island.

TNC purchased the property from the Gerards on September 2, 1999, for \$2.1 million. There were no conservation restrictions on the property when it was acquired by TNC, and TNC acquired the property with certain subdivision rights. TNC sold the entire 9.38 acres of unimproved land to Dougherty on October 28, 1999, for a purchase price of \$500,000.

Negotiations with Gerards and Dougherty

On March 8, 1999, and at the request of TNC, Marchitelli Barnes & Company, Inc. (“MB&C”) appraised the Thompson Hill property at \$2.0 million as of January 20, 1999. The appraisal described the property as a 9.38 acre parcel of residentially zoned land on Thompson Road in Shelter Island. The appraisal noted the site consisted of a peninsula extending toward Mashomack Preserve into the waters of Clark’s Cove at Nicoll’s Creek, with topography

¹⁶¹ The Thompson Hill property was owned by C.H. Coster Gerard, the Estate of James Gerard, and Sumner Gerard, Jr., as tenants in common.

¹⁶² Appraisal dated October 22, 1999, of the conservation easement, *see* Appendix O.

¹⁶³ Appraisal dated October 22, 1999, of the conservation easement, *see* Appendix O.

reaching elevations of up to 70 feet above sea level. Based on MB&C's highest and best use analysis, it appeared that the site was capable of being subdivided into three waterfront building plots and a small wetland preserve. The appraisal letter acknowledged that TNC intended to use the appraisal in negotiating its purchase of the property.

On March 25, 1999, TNC sent a letter to Dougherty regarding the potential availability of property to be acquired by TNC for sale to Dougherty. TNC stated it expected to be made whole and receive from the buyer a conservation easement. In that letter, TNC indicated that it had been working with Gerard since 1980 to structure a scenario that would allow for a single home development on the Thompson Hill property while protecting its important ecological features. The letter set forth several proposed easement restrictions to be placed on the property, including those to protect the watershed and biological integrity of Miss Annie's creek, and others to insure that the natural sediment transport that influences the Mashomack Preserve shoreline was not impeded. The letter referred to an upcoming meeting with Dougherty on the following Saturday to discuss the potential purchase of the property by Dougherty.

On April 2, 1999, TNC made a formal offer to acquire the property from the Gerards for \$2.1 million. On April 7, 1999, the Gerards make a counteroffer to TNC, which was rejected by TNC on April 12, 1999. On April 15, 1999, TNC amended its offer to extend the closing date to accommodate certain section 1031 like-kind closing date issues for one of the Gerards with respect to a one-third interest of the property. The amendment to the offer did not modify the \$2.1 million purchase price offer by TNC. On April 23, 1999, the Gerards accepted TNC's offer.

On June 8, 1999, TNC sent the Gerards a letter with execution copies of a purchase agreement to acquire the property from the Gerards. On June 11, 1999, the TNC Board approved the acquisition of Thompson Hill from the Gerards for sale by TNC to a conservation buyer. The documents supporting the request for Board approval noted that the proposed purchase price of \$2.1 million was within 10 percent of the appraised fair market value of the property of \$2.0 million.

On June 29, 1999, TNC sent \$105,000 as a down payment on the property. On or about June 30, 1999, TNC and the representatives of the Gerard family executed the purchase agreement to acquire Thompson Hill from the Gerards for \$2.1 million.

On August 6, 1999, Jonathan Kaledin, State Counsel for TNC, prepared a memorandum addressed to the Doughertys and others regarding the documents and structure of the TNC transaction with the Doughertys. The memorandum summarized a meeting among Dougherty, Kaledin, and Dougherty's counsel (Rich Upton) the previous day. The memorandum acknowledged that they first discussed "the tax/charitable deduction aspects of the transaction," and stated that "[i]n order to create as clean a paper trail as possible for Jim and Nancy, so as to minimize whatever IRS risks might exist from having a sale/donation occur, we have agreed to sign the contract and the pledge (the pledge will not have contingency language in it) and convey the [Thompson Hill] property to Jim and Nancy simultaneously on the same day that the Conservancy acquires the [Thompson Hill] property – after TNC's acquisition" (underlining in original). The memorandum acknowledged that the parties discussed the possibility of interest

costs in the event Dougherty did not satisfy the charitable pledge by September 30th. The memorandum also stated that the parties needed to get together to finish work on permitted areas, viewshed areas, cut restriction lines, and the dock area, regarding the easement and survey.

On August 30, 1999, Jonathan Kaledin sent a memorandum to Michael Dennis of TNC regarding a potential conflict of interest with respect to the Dougherty purchase, because of the Doughertys being “long time supporters” of TNC and Nancy currently sitting on the Mashomack Preserve’s Board of Trustees. In the memorandum, Kaledin noted that the Doughertys had agreed to make TNC whole with respect to TNC’s acquisition costs of the property through the acquisition and pledge structure, and that the Doughertys would pledge a charitable contribution “above and beyond the outsale’s purchase price.”

The memorandum notes that although it is true that TNC “gave an ‘insider’ [the Doughertys] the first crack at acquiring the Property from [TNC],” TNC “minimized its transactional financial risk by lining up a conservation buyer prior to acquiring the Property.”¹⁶⁴ Handwritten notes on the copy of the memorandum provided to the Committee evidence the consent of John Sawhill and Dennis, with Dennis stating he was “ok with this” because TNC had “solid appraisals” and the Doughertys “stayed out of the decision making process.”

Agreement to sell property to Doughertys and the accompanying pledge agreement

On October 28, 1999, TNC and the Doughertys executed and closed on a purchase agreement pursuant to which TNC transferred to the Doughertys the unimproved Thompson Hill property, and TNC retained and reserved a conservation easement on the transferred property. The delivery of the deeds pertaining to the transfer of the real property and the grant of the conservation easement was accompanied by the execution by the Doughertys of a Pledge Agreement. The property conveyed to the Doughertys was the entire property acquired by TNC from Gerard. The deed reserved and retained a conservation easement, whose terms and conditions were set forth in a separate easement document.

Under the terms of the purchase agreement, the Doughertys paid TNC \$500,000 at closing. Under the terms of the Pledge Agreement, the Doughertys agreed to pay TNC an additional \$1,652,000, as follows: \$650,000 on October 29, 1999 (the day after closing on the property); \$372,000 on November 30, 1999; \$300,000 on January 28, 2000; and \$330,000 on January 29, 2001. Thus, the Doughertys made total payments of \$2,152,000 for the property. The Pledge Agreement did not refer to the Thompson Hill property or to the purchase of the property by the Doughertys from TNC. The Pledge Agreement was to provide TNC the funds to reimburse it for its acquisition costs of acquiring the property, as well as direct costs incurred in acquiring and selling the property. The Pledge Agreement stated that the pledge “may be enforced by [TNC] by an action for specific performance or by any other appropriate remedy by any court having jurisdiction. It is further understood that this Pledge is a binding obligation on Pledgor, their

¹⁶⁴ A February 14, 2000, letter from Kaledin to Shelter Island Town Counsel, explaining TNC’s role in the transaction, *see* Appendix O. The letter stated that there had been several other persons interested in acquiring the property from TNC.

estate, successors, administrators, and assigns.” The Pledge Agreement was governed by the laws of the State of New York.

On the real property transfer report dated October 28, 1999, both James and Nancy Dougherty were listed as buyers, and Nancy Dougherty signed as the buyer. The consideration reported on the report was \$500,000.

An October 29, 1999, TNC memorandum from Melanie Woullard (Legal) to Bethany Seebach (Accounting) regarding accounting for the transaction requested information from Seebach regarding how to account for the purchase and charitable components of the transaction.

Summary of conservation easement

The conservation easement was effected by delivery of a deed from the Doughertys to TNC on October 28, 1999, the date the Doughertys acquired the property from TNC. The conservation easement granted by the Doughertys to TNC permitted the Doughertys to use the property for “single family residential purposes, including a professional office or customary home occupation engaged in by the residents,” and certain other structures within a permitted use area (sec. 2 and 2.1(a)). The easement prohibited certain types of structures (sec. 2.1), and subdivision of the property (sec. 2.9), and imposed certain conservation restrictions on the property. Under the terms of the easement, the Doughertys or their successors were permitted to construct one single family residential structure (with no square footage limitation referred to in the easement), and “accessory structures incidental and ancillary thereto, such as garages, a swimming pool, tennis court, home office space, a guest cottage, a writer’s cabin, etc.” The easement provided that none of its terms shall give or grant to the public a right to enter upon or to use the property (i.e., no public access rights) (sec. 5). The permitted use area was approximately 2.75 acres.

Appraisal and valuation letter

TNC and the Doughertys obtained a separate appraisal of the value of the conservation easement.¹⁶⁵ The appraisal, dated October 22, 1999, indicated that the easement will be made with the intention that it qualify as a conservation easement under section 170(h). The appraised value of the conservation easement was \$1,594,000, which was approximately the \$1.6 million amount that TNC and the Doughertys used to establish the purchase price as \$500,000. The appraisal valued the land before the grant of the easement at \$2.1 million,¹⁶⁶ and after the grant of the easement at \$506,000. The appraisal assumed single family use for the 2.75 acre permitted use area of the property, with the remaining 6.6 acres encumbered with a conservation easement and remaining in a natural state. The appraisal valued the 2.75 acre plot at \$460,000,

¹⁶⁵ Appraisal dated October 22, 1999, of the conservation easement, *see* Appendix O.

¹⁶⁶ The appraisal stated that the “recent sale of the subject for \$2,100,000 will establish its value before the granting of the conservation easement and we have not prepared an appraisal of the subject’s value before granting of the conservation easement.” Appraisal dated October 22, 1999, of the conservation easement, *see* Appendix O.

and the 6.6 conservation area at \$46,000.¹⁶⁷ The appraisal stated it was a qualified appraisal for Federal income tax purposes, and was not intended for any other use.

The appraisal noted that the property lies in the AA Residential zone of the Town of Shelter Island, which permits primarily a single family residential usage on lots having a minimum size of 80,000 square footage. The zone does not permit commercial or industrial uses, and a zone change to other than a residential use “is not deemed likely.”¹⁶⁸

It appears that the \$500,000 stated purchase price for the property also was the consideration used to determine the local transfer tax payable by the Doughertys on the acquisition.¹⁶⁹

Included in Appendix O is a copy of a letter from Robert J. Lanahan, Chairman, Board of Assessors, to the Shelter Island Town Board Members. The subject of the letter was the valuation of the Shelter Island property transferred by TNC to the Doughertys for purposes of Community Preservation Fund taxes due the Town of Shelter Island with respect to the property. The letter states that Lanahan, in his capacity with the Board of Assessors, did not consider TNC's purchase from the Gerards to be an arms-length sale, and that the \$2.1 million purchase price paid by TNC was "somewhat lower than could have been obtained in an open market sale." In the letter, Lanahan also states that "the cash payment [paid by the Doughertys] for the property was reported as \$500,000.00. A more realistic value for the property is probably about \$1,500,000.00." Lanahan noted that the "payment structure" involved in the transaction had the effect of "considerably reducing" the transfer tax due.

Tax advice and discussions

August 5, 1999, James Dougherty and TNC met to discuss the structure of the transaction and certain tax risks associated with the “tax/charitable deduction aspects of the transaction.” This meeting was memorialized in the August 6, 1999, memorandum from Jonathan Kaledin, State Counsel for TNC, to Dougherty and others. The memorandum acknowledged that at the meeting they first discussed “the tax/charitable deduction aspects of the transaction,” and stated that “[i]n order to create as clean a paper trail as possible for Jim and Nancy, so as to minimize whatever IRS risks might exist from having a sale/donation occur, we have agreed to sign the contract and the pledge (the pledge will not have contingency language in it) and convey the [Thompson Hill] property to Jim and Nancy simultaneously on the same day that the Conservancy acquires the [Thompson Hill] property – after TNC’s acquisition” (underlining in original).

A September 22, 1999, memorandum from Stephen J. Schreiber to Kaledin notes that Dougherty’s counsel wanted assurances that TNC could make a representation that the South

¹⁶⁷ Appraisal dated October 22, 1999, of the conservation easement, *see* Appendix O.

¹⁶⁸ Appraisal dated October 22, 1999, of the conservation easement, *see* Appendix O.

¹⁶⁹ Letter dated October 21, 1999, from Stephen Schreiber of Patterson, Belknap, Webb & Tyler to Peter J. Matheis of Philip O’Hara Associates, Inc., regarding closing instructions for the transfer from TNC to Dougherty. Peconic Bay Region Community Preservation Fund form regarding computation of transfer tax due *see* Appendix O.

Fork-Shelter Island Chapter is exempt under section 501(c)(3) for purposes of the Dougherty gift to be made pursuant to the charitable pledge.

In a February 14, 2000, letter from Kaledin to Shelter Island Town Counsel, Kaledin stated “[o]f course, the transaction between the Conservancy and the Doughertys was structured with both conservation and tax consequences in mind. Yet, as explained above, the structure of the transaction, as conceived and consummated, was built around independent appraisals of the property before and after the conservation easement. It is also important to remember that the transaction accomplished important conservation easements for the community.”

It appears that TNC did not solicit or obtain any tax advice pertaining to this specific transaction. None of the written tax opinions provided by TNC to the Committee relate to this transaction.

Form 8283 reporting

The parties treated this as a contribution of cash, rather than of a conservation easement, by the Doughertys to TNC. Accordingly, no Form 8283 was filed by the parties with respect to the claimed charitable deduction.

V. CBP Transaction – Davis Mountain

Observations

1. Related party. Caroline Alexander (Forgason) was a member of Board of Governors for TNC, Texas for a number of years preceding and following the transaction, which may have made it easier for TNC to structure the pledge and sale transactions.
2. Valuation. The Staff notes that TNC may not have performed adequate due diligence with respect to the valuation of this property.
3. Donative Intent. The documentation makes clear that TNC required the buyers to pay a premium to obtain the properties, which the Staff considers to be relevant to a determination regarding the existence or absence of donative intent on the part of the buyers.

Overview

TNC acquired approximately 32,529 acres of ranch land in the Davis Mountains area of West Texas. TNC’s purchase price for the ranch land was \$10.7 million. TNC had obtained an appraisal of the property which indicated a fair market value of \$11.4 million. TNC acquired the ranch land with the objective of selling ranch tracts to conservation buyers in order to fund most of the purchase price of the project. TNC intended to retain 9,475 acres as a preserve.

TNC subsequently sold most of the property to Caroline R. Alexander Forgason (“Forgason”), an individual who was affiliated with TNC through her service as a Texas State

chapter trustee for TNC for several years.¹⁷⁰ Alexander acquired the properties from TNC in two separate transactions, one in which she was the acquiring party, and the second in which a company she owned was the acquiring party.

By Special Warranty Deed dated December 22, 1997, TNC transferred to Forgason approximately 5,854 acres of the property. The warranty deed provides that the reservation of a conservation easement is attached as Exhibit B and is made part of this deed. The Conservation Buyer Transactions (Related Parties) Summary (“Summary”) indicates that 5,854.17 acres were sold to Caroline Alexander. One appraisal in the file is an appraisal of 5,854.17 acres of the McIvor Ranch. The property was appraised for \$1,900,000. The Summary lists the TNC purchase price as \$1,901,876 and the TNC sales price as \$1,160,834. The Summary states that the appraisal of the property on disposition was \$1,170,000. The transfer of 5,854.17 acres was the first Davis Mountains transaction between Caroline Alexander (Forgason) and TNC.

On October 12, 1998, James J. Jeffries, MAI,¹⁷¹ provided a letter to TNC regarding the value of 27,518.78 acres in the Davis Mountains, the Glass-Glen Burnie property also known as the Caldwell Ranch. TNC had requested that Jeffries provide “some preliminary valuation” of the property, which TNC had estimated to be worth approximately \$250 per acre. Jeffries specifically stated in the letter that, as he and TNC had agreed, “this writing is not an appraisal” of the subject property, but rather, a “confidential value consultation document between [them], with both of [them] fully recognizing the limitations of the work effort. It is specifically disclosed that I have not made a field inspection of the Caldwell Ranch nor have I completed any type of specific comparative analysis to directly relate any comparable sales to the Glass-Glen Burnie Foundation Tract.” Jeffries provided a “preliminary and grossly limited conclusion” that the subject property’s assignment price of \$220-\$250 per acre would fall within a normal range of prices for the subject’s region, given its subdivision potential, desirable recreational amenities, size and location.

Forgason made a charitable pledge for the benefit of TNC by a written pledge agreement dated August 12, 1999. Forgason is identified as the sole owner of Davis Mountains Land and Cattle Company. The Pledge recites that Davis Mountains Land and Cattle Company and the Pledgor have entered into a contract with TNC of Texas to purchase 27,133 acres of land in Jeff Davis County, of which this pledge is an exhibit. Such purchase is to be effected at a price equal to the full fair market value of the property, as determined by independent appraisal. This pledge is equal to the value of a conservation easement retained by TNC. The Pledge continues with the recitals that TNC, in pursuit of its conservation purposes, caused the property to be subject to a perpetual conservation easement. Further, the Pledgor desires to make a substantial charitable contribution to TNC to support its conservation efforts, in an amount sufficient to offset the monetary detriment attributable to TNC’s creation and imposition of the Conservation Easement

¹⁷⁰ The Summary referred to in this narrative description indicates that Caroline Alexander (also called Caroline Forgason) served as a trustee on the Texas Board of Trustees of TNC from 1993 to 2003. She was also the president and majority owner of Davis Mountain Land & Cattle Company, the company which acquired property from TNC in the 1999 transaction described herein.

¹⁷¹ Member of Appraisal Institute.

over and upon the Property. The Pledgor promises to contribute to TNC real property, cash and securities of not less than \$2,839,717, subject to adjustment at closing.

By a special warranty deed dated August 23, 1999, TNC transferred the 27,133 acre property to Davis Mountains Land and Cattle Company (owned by Forgason). The deed contained the reservation by the Grantor of a conservation easement over the property as set forth in the Caldwell Ranch Deed of Conservation Easement attached as Exhibit B and made a part of the deed.

The file contains an appraisal of the property as of February 4, 1999. The fair market value is listed at \$7,570,000. The Summary lists the estimation of the value of the property with the easement imposed of \$5,426,632. The Summary also lists this amount as TNC's sale price. The Conservation Buyer Transaction Summary contains the information that no separate appraisal with the easement imposed was obtained by TNC. However, the value estimation (not an appraisal) of the property is based on a hypothetical conservation easement. The value attached to the property was \$200 an acre. At the rate of \$200 an acre for 27,133 acres, the value is \$5,426,600, the number derived in the Summary.

On October 5, 1999, Forgason transferred 3,696.43 acres of property to TNC, in a transaction characterized as a charitable contribution for which a Form 8283 was filed. Forgason reported that she had acquired the property in December 1997 by purchase for a cost of \$729,224, and that the property had a fair market value of \$739,286 at the time of the donation. It appears that the contribution amount approximates the excess of the \$1.9 million appraised amount for the property acquired by Forgason from TNC in 1997, over the stated purchase price of \$1.17 million. Thus, it appears that Forgason claimed a charitable deduction of \$729,224 for the 1999 donative transfer of property she had acquired in 1997, and a cash contribution deduction of \$2.8 million for the pledged amount pertaining to the 1999 acquisition by Davis Mountains Land and Cattle Company.¹⁷²

The file contains the letter of TNC dated January 29, 1997, to Steptoe & Johnson in Washington, D.C., requesting tax advice on the structure of purchase of conservation land "at a premium." The question is how the transaction should be structured for federal income tax purposes. The letter first starts by describing the overall transaction. To finance most of the project, TNC intends to sell most of the ranch tract to conservation buyers. The letter states as follows:

To meet our conservation goals the Conservancy must retain a substantial portion of the economic value of the property. . . thus, we, are requiring the various tract buyers to pay a premium to cover our costs, and provide for start-up expenses and a stewardship endowment. The Board of Governors has made it clear that the Texas chapter must have

¹⁷² The staff did not confirm whether the company is a corporation, in which case Forgason is making a charitable contribution individually for property acquired by her corporation. A recharacterization of the pledge might be in order in such a case, with the result that Forgason is viewed as making a capital contribution to the corporation, and any charitable deduction would be that of the corporation, not Forgason individually.

\$8 million in income from the sale of tracts closed simultaneously with the purchase of the property. (Emphasis added).

Steptoe & Johnson replies to TNC with a letter dated March 10, 1997, giving TNC the go ahead with respect to structuring the sale with a “premium” attached.

The charitable pledge of Forgason is revealing in that it precedes the land transfer by a few days and it refers directly to the contract for the sale of land by TNC to the Pledgor as if the Pledge was a part of the larger land transaction. Further, the Pledge recites that the Pledge is equal to the value of a conservation easement retained by TNC.

VI. Emissions Credits – General Motors Atlantic Rainforest Restoration Project¹⁷³

On June 9, 2000, General Motors Corporation (GM), General Motors do Brasil Ltda. (GMB), Sociedade de Pesquisa e Vida Selvagem e Educacao Ambiental (SPVS), and TNC executed the Comprehensive Agreement For The General Motors Atlantic Rainforest Restoration Project (Project).¹⁷⁴ The Project is a forty year climate action mitigation project in the municipality of Guaratuba on the coastal plain of Parana State in southeastern Brazil. The objective of the agreement was: (1) the implementation of a climate action mitigation project to protect plants and animals; (2) to protect biodiversity on the project site; (3) to mitigate greenhouse gases in the earth's atmosphere, principally through reforestation and the prevention of deforestation; (4) to sequester carbon from the earth's atmosphere as rapidly as possible without compromising the biodiversity of the Project; (5) to promote sustainable development; and (6) to generate certified credit offsets for GM.¹⁷⁵ The agreement provided that it was not intended to be, and shall not be construed to have created, a partnership, joint venture, or other business arrangement, nor was it a principal purpose of the parties to enter into a commercial undertaking. The agreement prohibited any of the parties from filing or making any form or return that took a position inconsistent with the stated intention.

The agreement was signed on behalf of GM and GMB by John F. Smith, Jr., then-Chairman of the Board and Chief Executive Officer of General Motors Corp., and a member of TNC's Conservation Committee and 2000-2001 Board of Governors. Mr. Smith voted, as a member of TNC's Conservation Committee, to approve TNC's participation in the agreement on April 26, 2000.¹⁷⁶ TNC's states on its Forms 990, Statement 24 for 2000, 2001 and 2002, that "Mr. Smith did not participate or vote on said transactions." Mr. Smith is no longer Chairman of General Motors Corporation, but serves as Special Advisor to the Company, and was a member of TNC's Board of Governors for 1999-2003.

The Project's aim was to create an approximately 30,000 acre private nature reserve in Brazil through land acquisition, active restoration, and long-term management for forest and biodiversity protection. In the materials provided to the TNC Board of Governors, TNC

¹⁷³ See Appendix Q for documents related to this transaction.

¹⁷⁴ GMB is a Brazilian limited liability company affiliated with GM. SPVS is a Brazilian non-profit conservation organization.

¹⁷⁵ For this purpose, a credit offset means one metric ton of Carbon equivalent demonstrated by the project site manager to be mitigated, reduced, avoided, sequestered or fixed in any calendar year. According to one source, greenhouse gas air credit trading has emerged as a mechanism to reduce greenhouse gas (GHG) emissions such as carbon dioxide and methane. www.emissionstrading.com/defined.htm ("While the global mandate for reducing GHG emissions is not yet in place, it may yet emerge out of the December 1997 Kyoto Conference. Participating countries agreed to specified GHG emissions budgets that are tied to 1990 emission levels. Participating sources within each country may then be allocated a proportional share of the budget and/or allowed to participate in an auction to acquire such GHG allocations. GHG allocations can be used to mitigate the impact of defined GHG producing activities, sold to GHG emitting sources without a sufficient supply to meet anticipated needs, or stored for later use or sale.")

¹⁷⁶ Fax Ballot for Brazil Atlantic Rainforest Restoration Project, Brazil dated April 28, 2000, from Mike Dennis to various persons.

estimated that 1.5 to 2.0 million tons of carbon would be sequestered on the project area over the 40-year life of the Project. Those materials state that the Project “may allow General Motors Corporation to receive recognition and greenhouse gas emission offsets. Without compromising biodiversity objectives, [TNC] will design the project plan to place General Motors in a position to be eligible for carbon offsets.” The TNC Executive Committee of its Board of Governors, and the TNC Conservation Committee, approved TNC’s participation in the agreement on April 25, 2000.¹⁷⁷

The April 10, 2000, Preliminary Project Plan stated that with a \$10.0 million investment from GM, the project will promote assisted natural forest regeneration on pastures and degraded forests on the acquired lands, and that the project aims to “produce significant net carbon benefits” that “will be quantified and validated in such a way as to maximize the probability that they will be accepted under any future international carbon trading regime.” The April plan document stated that TNC will carry out its financial management and technical assistance responsibilities as to improve the possibility that the net carbon benefits generated by the Project will be recognized and credited under a future international greenhouse gas carbon trading regime, and to achieve the Project’s biodiversity goals. The plan document went on to say that “[a] primary goal of the project is to generate as much as 2 million tons of carbon benefits that are scientifically quantifiable and long-lasting and that will be recognized as certified carbon offsets eligible for credit under a prospective international carbon trading regime,” and that the project partners “will make every effort to maximize the possibility that the carbon benefits generated by the project will ultimately be accepted, credited, and available to GM to meet its emission-reductions targets.” In the plan’s description of the “strategy to obtain credits for the greenhouse gas emissions reductions generated by the Project,” the plan acknowledged the Brazilian government’s reluctance to accept forest conservation projects to receive credits, and stated that the parties’ actions prior to November 2000 “will focus especially on participation in the debate concerning the crediting of forest conservation projects.”¹⁷⁸

Authority and responsibility for the Project are allocated among the Project Executive Committee, Project Site Manager, and Project Funds Manager. The Project’s Executive Committee is responsible for making certain advisory recommendations and binding decisions. The Executive Committee consists of four members, one representing each of GM, GMB, SPVS, and TNC. Advisory recommendations require the approval of three of four members. Binding decisions require the agreement of all four members. Thus, GM and GMB possess 50 percent control of the Executive Committee, and each member (including TNC) possesses veto power over binding decisions. Binding decisions include, among other things, approval of annual work

¹⁷⁷ It appears that the agreement also was approved by TNC’s International Committee before April 25, 2000. It is unclear whether the transaction was submitted for approval by the Executive Committee to the full Board of Governors.

¹⁷⁸ According to the plan document, two of the four elements of the project partners’ core strategy were to “inform key decision-makers in the climate change arena about the benefits of forest conservation projects” (noting that “all three project partners have pre-established channels of communication with key actors within the Brazilian Government on the climate change debate. The partners will thus coordinate to engage Brazilian officials and keep them apprised of the Project.”), and to “position the project as a CDM [Clean Development Mechanism] pilot project for the Brazilian Government” (noting that “project partners will engage and inform U.S. officials to promote the project’s acceptance under guidelines established by this government”).

plans and budgets, approval of any sale, lease, or other disposition of the project site, and the determination of when to submit any filing, submission, or registration of any credit offsets generated by the Project.

SPVS, as the Project Site Manager, was principally responsible for managing and implementing the Project. TNC, as the Project Funds Manager, was responsible, in consultation with the Executive Committee, for providing financial management services as set forth in the agreement. TNC's duties included establishing and maintaining project funds accounts within TNC to fund the Project's expenditures, disburse funds to the Project Site Manager in accordance with annual work plans and budgets, sending financial reports to GM and GMB, and establishing and maintaining the Project's endowment fund. GM's duties were to provide financing for the Project (\$500,000 at the start of the Project and \$9.5 million within 30 days of the agreement), and, with GMB, to consult with TNC and SPVS regarding the financing and implementation of the Project. Under the agreement, TNC could not assign any of its duties or obligations under the agreement without GM's consent. GM was permitted to assign all or any portion of its interest [in the agreement] to any third party subject to approval of the other Parties "which approval may not be reasonably withheld.

The agreement recitals state that the parties wished to convey to GM any credits or benefits which may result from this endeavor to the extent related to efforts by any country to achieve sustainable development and to meet any net greenhouse gas emissions reduction goals either through the UNFCCC¹⁷⁹ (including any protocols related thereto, including but not limited to the Kyoto Protocol) or otherwise. GM was the sole recipient of the credit offsets under the agreement. The agreement required all parties to perform their duties in a professional and efficient manner using due diligence to prevent unnecessary injury or damage to the credit offsets produced on the project site. The parties agreed to cooperate to submit the necessary documentation for obtaining certification of credit offsets as was consistent with "the Project objective of generating [credit offsets] on as rapid and regular a basis as is feasible." The agreement provided that each credit offset constituted an "unconditional marketable private right" for GM, or GM's successor in interest or permitted assignees, to register the offset and to count such offset toward compliance by GM, or its successor in interest or assignee, with its current or potential future greenhouse gas limitation obligation or commitments, voluntary or otherwise. No credits were guaranteed or warranted under the agreement, and there was no cap or limitation on the value of emission credits GM could realize from the arrangement.¹⁸⁰

Under the agreement, TNC made the following covenants: (1) not to sell, assign, convey, lease or otherwise dispose of all or a substantial part of TNC's assets or real properties to the

¹⁷⁹ United Nations Framework Convention for Climate Change.

¹⁸⁰ Although the Kyoto Protocol has not been ratified, a market emissions credit trading has emerged. According to one source, the right to emit a ton of carbon dioxide traded for between \$3 and \$6.50 as of January 2004, and that experts predict prices will rise if the Kyoto Protocol is implemented. The Asahi Shimbun, January 17, 2004. According to that source, credits for about 70 million tons of emissions were traded during 2003. Another source stated that demand for the credits more than doubled during 2003, with credits beginning the year at EUR6 (approximately \$7 (US)) and ending the year at EUR12.50 (approximately \$15 (US)). www.bellona.no/en/energy/32069.html (citing Politiken).

extent such action would have an effect on the Project, whether such assets or real properties are now owned or hereafter acquired, except for the replacement of capital assets with assets of equal or greater value; (2) not to voluntarily dissolve, liquidate or otherwise cease to do business during the term of the Project; (3) not to change the nature or scope of the Project without the written consent of the other parties; (4) not to change TNC's articles of association or other organizing documents in a manner that would be inconsistent with the provisions of any Project Document; (5) not to enter into any partnership, profit-sharing or royalty agreement or other similar arrangement whereby Project Disbursement are or might be shared with any person, except as specifically authorized in a Project Document; (6) to maintain its corporate existence and its right and authorities to carry on the Project; (7) to assist GM in defending the conveyance of credit offsets transferred under the agreement, against the claims of any person including by providing any documentation in its possession; (8) to ensure observance of confidentiality with regard to any restricted information or confidential information or data disclosed to it; and (9) not to sell, assign, convey, lease or otherwise dispose of any of the real estate or assets which comprise the Project without the written approval of the Executive Committee. Under the agreement, the fund accounts maintained by TNC for the Project were only to be used for the purposes of supporting the Project. Any income from any use of the project site during the project term must be used solely for the benefit of the Project unless otherwise decided by the Executive Committee. Under the agreement, if TNC ceased to exist or substantially restructured to the point where its activities in Brazil cease to be a priority, such cessation or restructuring constituted an event of default. TNC could not amend or terminate the agreement without the written consent of all of the other parties to the agreement.

VII. Joint Ventures

a. Conservation Beef

Observations

1. Joint Venture Participants. TNC describes CBL as a joint venture with another charitable organization, AWF. In its March 3, 2004, response TNC provided a form of Joint Venture Agreement with respect to PM Holdings, LLC, a for-profit entity.¹⁸¹ The Staff notes that the form of Joint Venture suggests that PM Holdings, LLC would be a member of the venture. TNC later states that “CBL had a verbal agreement with PM Holdings, LLC on terms similar to those described in the form of Joint Venture.”¹⁸² “Due to changed circumstances and the performance of PM Holdings, LLC, the two parties never formalized a joint venture agreement. Instead, CBL elected to hire a salaried president to direct and implement much of the work CBL had originally intended PM to perform.”¹⁸³ In verbal conversations with the Staff, TNC stated that it never executed the form of Joint Venture with PM Holdings, LLC and that PM Holdings, LLC only provided services in a contracting capacity.
2. Profitability. The joint venture turned out to be very unprofitable from TNC’s perspective. Conservation Beef, LLC did not have an operating profit for any year in which TNC participated in the joint venture.
3. Tax Analysis. TNC apparently did not conduct any tax analysis to determine the tax consequences to TNC of participating in the joint venture with AWF, or the effect the relationship with PM Holdings, LLC would have on TNC’s tax consequences.
4. Potential Tax Issues. The joint venture arrangement is an example of a dual purpose arrangement, in which TNC attempted to further conservation purposes at the same time it provided substantial financial benefits to third parties (including non-exempt parties) with whom the joint venture conducted business. Such arrangements may implicate exempt purpose, private benefit, and unrelated business income tax issues.

Overview¹⁸⁴

The concept of the conservation beef program originated with William Weeks and Brian Kahn, both senior staff employees of TNC, in 1995. Kahn subsequently moved to Artemis

¹⁸¹ See Appendix S.

¹⁸² TNC Narrative Response dated January 14, 2005.

¹⁸³ Id.

Wildlife Foundation (“AWF”)¹⁸⁵ where he remained interested in the conservation beef program idea. TNC, through its operating unit Center for Compatible Economic Development (“CCED”), formed Conservation Beef, LLC (“CBL”), a Montana limited liability company, in partnership with AWF in 1999. TNC and AWF approached and received support from the W. Alton Jones Foundation for initial support for the project.

On January 1, 2003, TNC was formally substituted for CCED in CBL’s operating agreement. TNC and AWF each had a fifty percent (50%) ownership interest in CBL until TNC withdrew from CBL on February 19, 2004.

CBL reported that the net income or loss of CBL furthered the exempt purpose of its members, “to wit: in the case of Artemis Wildlife Foundation, to conserve biologically significant lands in the Western United States by developing market forces that will support economically sustainable and ecologically sound livestock ranching; and in the case of The Nature Conservancy, to be operated, exclusively for educational, scientific and charitable purposes.”¹⁸⁶

Description of operations¹⁸⁷

CBL is a sales and direct-marketing organization that markets fully mature, range-fed, additive-free, healthful beef (“Conservation Beef”) to the consumer and corporate gift markets, and to a small number of highly visible, food-source conscious restaurants.

CBL’s mission is to conserve biologically significant lands in the western United States by developing market forces that will support economically sustainable and ecologically sound cattle ranching. CBL’s means to accomplish that mission is to create a niche market for Conservation Beef that will return a premium price to ranchers who commit to long-term land conservation strategies.

Conservation Beef is produced only on western landscapes of the highest ecological value by ranchers who commit, through strategic alliances with CBL, to long-term conservation of their open lands through ecologically sound land stewardship practices, land-use planning, and conservation easements. CBL works with its rancher-suppliers to develop those stewardship standards and coordinates the work of an independent panel of scientists and ecologists who monitor and certify adherence to the standards and evaluate their beneficial impacts on ecosystem health and wildlife habitat. TNC maintains that the financial rewards to be provided to the rancher suppliers help economically sustain responsible operators and thus encourage

¹⁸⁵ AWF reportedly is a California nonprofit corporation and charitable organization described in section 501(c)(3).

¹⁸⁶ Attachment to Statement 3, Federal Supplemental Information, Form 1065 for CBL for 2003; see also, section 3.1 of the Operating Agreement dated October 20, 1999, *see* Appendix S.

¹⁸⁷ This description of the Conservation Beef joint venture is based on narrative descriptions provided by TNC to the Committee, as well as on the organization’s organizational documents, transactional documents, Federal tax information returns, and financial statements.

further sound land stewardship for large blocks of both publicly and privately owned land in critical areas of the western United States.

CBL had three employees in 2000, one of whom was full time. In 2002, CBL had four employees, three of whom were full time. All employees of CBL were eligible to participate in the TNC retirement plan.¹⁸⁸

For 1999 through 2003, CBL had a negative gross profit from its activities, i.e., gross receipts from sales were less than its inventory costs associated with those sales, before taking into account other administrative and operating costs. For example, for the calendar year 2003, CBL reported gross sales of \$304,836, and cost of goods sold relating to its inventory of \$435,888.¹⁸⁹ CBL's net losses were allocated 50-50 to each of TNC and AWF for 1999 through 2003.

CBL reported on its Form 1065 that its principal product was organic beef, and its principal business activity was sales.

Agreement with Artemis Wildlife Foundation and ownership of the joint venture

TNC (through CCED) and AWF executed an operating agreement as of October 20, 1999. At the outset, TNC contributed \$135,000 of cash and AWF contributed \$252,500 of cash to CBL (sec. 8.1), in exchange for equal 50% interests in the LLC.¹⁹⁰ Neither member was obligated to make additional capital contributions (sec. 8.2).

The operating agreement provided that management of the LLC was vested in the managers rather than in the members (i.e., was vested in the LLC's officers rather than in TNC and AWF as members). The managers were Brian Kahn, representing AWF, and William Weeks, representing TNC (secs. 1.22 and 5.2). CBL was not to take any action that did not further the exempt purposes of its members (sec. 3.1). Each member was permitted to withdraw from CBL at any time, and receive a payment in exchange for its membership interest under the terms and conditions agreed to by CBL and the withdrawing member (sec. 8.4). AWF was the tax matters partner for CBL (sec. 9.12).

Under the operating agreement, Kahn's powers as manager included acquiring property and miscellaneous administrative duties. Weeks' powers included determining which landscapes or watersheds met the company's ecological criteria for participation in the company's programs. Certain actions could not be taken without the consent of both managers, and a number of major

¹⁸⁸ The withdrawal agreement executed by TNC in 2004, described below, did not address whether CBL employees ceased to be eligible for benefits under TNC's retirement and other programs.

¹⁸⁹ CBL apparently reported its financial statements on a fiscal year basis (ending June 30), but reported its partnership return information on a calendar year basis.

¹⁹⁰ TNC stated that AWF also contributed its connections and relationships with cattle ranchers and the time and expertise of its staff, which the parties felt justified the equal ownership interests despite TNC's disproportionately larger cash contributions made over the course of the joint venture.

decisions (including establishing conservation standards to be used in conservation agreements) required the consent of both TNC and AWF as members (Article V).

TNC and AWF amended and restated the operating agreement effective as of January 1, 2003. The amended and restated operating agreement retained the respective interests of TNC and AWF at 50%, and acknowledged that TNC had contributed cash of \$1,150,864, and AWF had contributed cash of \$499,021, by that time. Under the amended and restated agreement, neither member was obligated to make additional capital contributions.

As more fully described below, TNC executed an agreement to withdraw from CBL effective as of February 19, 2004.

CBL's separate joint venture agreement with PM Holdings and related agreements

CBL entered into various agreements with other parties. CBL negotiated a Form of Joint Venture Agreement with PM Holdings, LLC ("PMH") in which CBL and PMH agreed to "pursue a joint venture to develop and expand marketing of Conservation Beef."¹⁹¹ PMH is a holding company that generated average sales of \$250 million annually and employed more than 700 employees, with subsidiaries including PM Beef Group.¹⁹² TNC reported that CBL and PMH had a verbal agreement on terms similar to those described in the Form of Joint Venture Agreement, but that due to changed circumstances and the performance of PMH, the two parties never formalized a joint venture agreement. This verbal agreement with terms similar to the form of joint venture agreement, combined with the agreement between TNC and AWF, may have had the effect of creating a joint venture among, TNC, AWF, and PMH, with respect to certain of CBL's activities for some period of time.

CBL entered into: (1) a PM-Conservation Beef Protocol for Live Animal Handling, Harvest, Beef Fabrication, Portioning and Shipping; (2) a Conservation Beef Option/Purchase Agreement with John Crumley; (3) a Conservation Beef Option/Purchase Agreement with Karl Ohs, dated May , 2000; (4) a Conservation Beef Option/Purchase Agreement with Sun Ranch, LLC, dated September 18, 2000; (5) a Conservation Beef Option/Purchase Agreement with John Crumley, dated September 10, 2001; and (6) a Conservation Beef Purchase Agreement with Sun Ranch, LLC, dated October 15, 2001. Under the cattle option/purchase agreements, sellers to CBL agreed to an introductory stewardship plan, and if they participated beyond one year, a full stewardship plan. All such stewardship plans were required to be approved by CBL in accordance with CBL's stewardship guidelines. Under these arrangements, ranchers are able to choose among a variety of acceptable strategies to achieve the stewardship goals, and may retain specific, limited development rights provided they are consistent with CBL's goals of conservation of landscape, watershed, and habitat integrity.

A copy of the Stewardship Guidelines is included in the Appendices. TNC reported that individual stewardship plans are subject to a confidentiality agreement between the rancher and

¹⁹¹ Form of Joint Venture Agreement with PM Holdings, LLC, *see* Appendix S.

¹⁹² PM Beef Group, LLC News Release, *available at* <http://www.pmholdings.com/heinenspressrelease.html>.

CBL, and that TNC does not have copies of these plans because it is no longer a member of CBL.

TNC's withdrawal from the joint venture in February 2004

As a part of a review by TNC of its related organizations, TNC identified CBL as 'a candidate for termination' in terms of participation by TNC. TNC withdrew from CBL effective February 19, 2004. The withdrawal was effected pursuant to an Agreement to Withdraw By and Between TNC and CBL of that date.

Pursuant to the withdrawal agreement, TNC relinquished its membership rights in CBL in exchange for \$225,000, including cash of \$100,000 and a promissory note from CBL in the amount of \$125,000 with interest payable at 3.02%. The withdrawal agreement provided that: (1) TNC retained all rights and interests in conservation agreements granted to TNC through the joint efforts of CBL and TNC, including the Sun Ranch easement valued on TNC's books at \$5.84 million; (2) CBL retained all rights and interests in the trademark Conservation Beef (CB Mark); and (3) the licensing agreement made on August 16, 2001, between TNC and CBL concerning use by CBL of the TNC marks was terminated.

Tax advice and analysis by TNC

TNC provided no information to the Committee staff regarding the tax analysis TNC conducted with respect to the treatment of its joint venture with AWF, or indirectly with PM Holdings and perhaps various ranchers, for Federal income tax purposes. The conservation beef program was not a subject of any of the tax opinions provided by TNC to the Committee. Apparently no tax analysis was conducted by TNC to determine the effect, if any, that the joint venture between TNC and AWF, or the relationship between CBL and PMH, would have on the Federal tax consequences to TNC or CBL.

Reporting on Form 990

For its fiscal years ended June 30, 1999, through June 30, 2001, TNC reported its contributions to CBL as grants and allocations (Part II, line 22). Effective for the Form 990 for the year ended June 30, 2002, TNC reclassified prior contributions to CBL as investments, and the losses allocable to TNC were reported as a component of gain or loss from sales of assets other than inventory (Part I, line 8). TNC noted that based on consultation with its auditors, it would report any income or loss from the 2003 Form K-1 consistent with the characterization of the amount on CBL's Form 1065.

b. Forest Bank

On January 17, 2001, TNC formed the Forest Bank, LLC ("FBLLC"), a Delaware limited liability company, to conduct a forestry conservation project. Upon the formation of FBLLC, TNC was its sole member. TNC acquired its membership interest in exchange for \$500,000 cash and an obligation to provide an additional \$250,000 cash on an as needed basis. TNC and

FBLLC sought private investors in the LLC to provide funding and working capital for the LLC's activities.

FBLLC sought to acquire from owners of forest land the rights to maintain, conserve, selectively cut, manage, sell, retain the proceeds from and regenerate the trees located on each owner's property in exchange for units of membership interests in FBLLC. The membership interests offered to investors would have entitled the holder to preferred annual distributions based on the value of the timber rights contributed to the LLC, and the limited right to withdraw the initial value of the timber rights contributed to the LLC for cash, subject to certain restrictions.

FBLLC was formed because TNC believed that small, non-industrial owners of forest land often sell the rights to harvest the timber to raise funds to meet pressing cash flow needs, without a long-term forest management plan. TNC believed this random harvesting jeopardizes the long term conservation of forests, threatens the environment, and may damage the long-term economic productivity of the landowner's forest. TNC and FBLLC sought to eliminate as much as possible the random cutting of forests that occurs because of such circumstances by acquiring permanent rights to manage standing timber, developing sustainable forest management plans for each contribution of timber rights, providing the landowner with a regular source of income in the form of preferred annual distributions from the LLC, and providing the landowner with the right to withdraw the initial value of the timber rights contributed to the LLC in cash without having to harvest that particular timber.

TNC and FBLLC conducted an initial public offering of three classes of the FBLLC membership interests in an attempt to sell FBLLC membership interests. In the offering materials, FBLLC stated its two primary objectives were to conserve forests, lands and watersheds of the regions in which it acquired timber rights, and to maximize the sustainable financial return to its members who contributed timber rights to FBLLC. The FBLLC agreement expressly required that in the case of a conflict between FBLLC's conservation objectives and economic objectives, the conservation objectives would take priority. Pursuant to a management agreement, TNC was to control the day-to-day management of the FBLLC operations. The initial offering materials stated that FBLLC was authorized to purchase timber rights for up to 10,000 acres of land.

FBLLC offered three different membership interests. Class A-1 interests provided for annual distributions equal to 4% per year of the initial value of the contributed timber rights. Class A-2 and A-3 interests provided for preferred annual distributions of 4.5% of the initial value of the contributed timber rights. Each of the classes provided for different withdrawal rights for investors who wanted to withdraw from FBLLC. Persons generally were eligible to become members if they owned at least twenty (20) acres of forest land in a project area designated by TNC.

FBLLC members were to convey timber rights to FBLLC by means of a forest conservation and management easement, which gave FBLLC the right to manage the member's timber, including the right to maintain, conserve, selectively cut, sell, retain the proceeds from and regenerate the trees located on the member's property. The easements were to permanently

prohibit any development of the land on which the contributed timber rights resided for commercial purposes or in any manner inconsistent with FBLLC's conservation objectives. Members exchanged rights to cut and manage their timber for rights to receive economic returns in the form of cash distributions. Members would continue to own the underlying land, and were able to use the land for recreational purposes. The contribution of the easement was permanent and irrevocable.

The governance provisions of FBLLC provided that members had little or no ability to control the operations of the affairs of the company, and could not vote on any matter concerning the LLC, other than the sale, merger, or consolidation of the LLC (which required the approval of 2/3 of the members and of TNC). TNC, as manager, had control over FBLLC's forest management and timber sale decisions. TNC was to work with each member to develop a management plan for the member's property, but TNC and FBLLC was not bound by that plan. In addition, TNC had the right to appoint, remove and replace all the members of TNC's board of managers, which were expected to always be employees of TNC. The management agreement provided that TNC was to provide management services to FBLLC free of charge for five (5) years.¹⁹³

On July 20, 2000, TNC received a private letter ruling from the IRS with respect to its participation in FBLLC that contained the following rulings: (1) TNC's participation as manager of FBLLC pursuant to the terms of the management agreement, and its obligations and activities with respect to FBLLC, would not impair TNC's status as an organization described in section 501(c)(3); (2) cutting and selling timber based solely on long-term conservation objectives does not constitute an unrelated trade or business; (3) cutting and selling timber based solely on revenue objectives, or where conservation objectives are merely incidental to revenue or other objectives, constitutes an unrelated trade or business, assuming that such activities are regularly carried on; (4) if sales of timber constitute an unrelated trade or business, gains from section 631(a) dispositions are not excluded under section 512(b)(5), although transactions coming within section 631(b) may result in gains therefrom being excluded under section 512(b)(5); and (5) membership interests in FBLLC do not constitute acquisition indebtedness as defined in section 514(c)(1).

FBLLC received opinions from an outside law firm, Hunton & Williams, that: (1) FBLLC would be taxed as a partnership for federal income tax purposes, and each member would be treated as a partner for such purposes; (2) a member would not recognize gain or loss upon the contribution of timber rights in exchange for LLC membership interests; (3) any gain recognized for federal income tax purposes from the LLC's harvesting activities would be treated as long-term capital gain; (4) the allocations of income, gain, loss, deductions, and credits in the LLC agreements should have substantial economic effect for purposes of the partnership allocation rules; and (5) the descriptions of tax law contained in the offering materials were correct in all material respects, and the discussions thereunder fairly summarized the federal income tax considerations that were likely to be material to an investing member. The offering materials

¹⁹³ The parties valued this five-year commitment of free management services at \$750,000, placing the value of TNC's initial membership interest at \$1,250,000 (including the \$500,000 cash).

disclosed the risk that the LLC might be treated as a publicly traded partnership, taxable as a corporation.

Despite a public offering of the membership interests, FBLLC was unable to attract any investors, and was dissolved on November 6, 2002.