



U.S. SENATE COMMITTEE ON

Finance

SENATOR CHUCK GRASSLEY, OF IOWA - CHAIRMAN

<http://finance.senate.gov>

For Immediate Release

Wednesday, March 3, 2004

Grassley, Baucus Continue Review of The Nature Conservancy

WASHINGTON – Sen. Chuck Grassley, chairman of the Committee on Finance, and Sen. Max Baucus, ranking member, today continued their independent review of The Nature Conservancy’s activities, transactions and practices. The senators sent a detailed letter asking questions about previously raised issues as well as new issues.

The text of the senators’ letter follows. The names of individuals who have not been named publicly in media reports have been redacted.

March 3, 2004

Mr. Steven J. McCormick
President and Chief Executive Officer
The Nature Conservancy
4245 North Fairfax Drive
Arlington, VA 22203-1606

Dear Mr. McCormick:

We appreciate the cooperation of The Nature Conservancy (TNC) with the Finance Committee’s independent review of TNC’s activities, transactions and practices. This letter is a follow-up regarding certain information the Finance Committee received from the first round of questions. Further, some questions (noted as such at the end of this letter) relate to new issues not raised in our earlier letter dated July 16, 2003.

I. Conservation Buyer Program

1. Identify each and all of the TNC conservation buyer transactions for the ten year period described in our letter of July 16, 2003 (whether related party buyers or non-related buyers),

that involved a charitable donation or charitable pledge made to TNC by the purchaser within a time frame beginning 6 months prior to closing on the land purchase from TNC and ending two years after the land purchase. For each such transaction list the amount and date(s) of payment of the contribution or pledge; attach a copy of the charitable pledge documentation; and attach any paperwork associated with the charitable gift—to the extent such information was not already provided in response to our prior letter.

2. In response to question 1, above, if the information has already been provided to us, indicate where each item may be found in such materials, including transaction number.

3. Questions regarding the Davis Mountains, Texas, property transactions:
 - a. Did _____ make a charitable pledge (or charitable contribution) with respect to the transaction for the 5,854 acres on or about December 22, 1997?
 - b. Why did _____ give back to TNC the land she had purchased two years before? Why did she give back just part of it and not all of it?
 - c. Was there anything different about the land she kept as opposed to the land she gave back such as an improvement of the land, or a special feature of the land retained (or given up)?
 - d. What did _____ end up paying for the land she retained? Was it approximately the sale price of \$1,160,834?
 - e. Did _____ pay the \$5,426,632 purchase price for the 27,133 acres? If not, what did she pay?
 - f. Did _____ pay the \$2,839,717 for the charitable pledge she made? If not, how much did she pay? When were payments made on the pledge?
 - g. Did _____ hold a position with TNC as a director, officer or employee? If so, discuss her position, her term with TNC, whether she continues to have a relationship with TNC, and, if so, in what capacity.
 - h. Attach all correspondence and other communications, including e-mail and any memos that relate to the purchase of Davis Mountains property by _____.
 - i. Please provide a copy of the January 31, 1992, opinion letter to _____ from Steptoe & Johnson, referred to in the January 29, 1997, letter from _____ to _____ of Steptoe & Johnson, regarding charitable contribution deductions for premiums paid for real property and donations of appreciated stock to pay the premium portion of the purchase price.

4. Questions regarding the Shelter Island (Thompson Hill) transaction:
 - a. The value of the conservation easement was appraised at \$1,594,000.00 as of October 28, 1999. When was this information conveyed to the TNC and the Dougherty's?
 - b. Did the _____ donate part of the land that now makes up Mashomack Preserve? If so, how much land and what percentage of the total? What was the then value of the gift?

- c. If yes to question b, above, describe the size nature and environmental importance of the Mashomack Preserve. Is TNC the owner/trustee?
 - d. The memo of August 6, 1999, from the TNC counsel to Jim Dougherty suggests that Dougherty may be required to pay interest via the charitable pledge if the pledge is not fulfilled by a certain date. Did the Dougherty charitable pledge that was actually made to TNC consist of a portion that may be considered attributable to an interest element? If so, please discuss in detail.
 - e. Did any of the sellers of the Thompson Hill property take a charitable deduction for a bargain sale of the Thompson Hill property? If so, please discuss and attach any relevant documents.
 - f. State the date and the amounts actually paid and/or to be paid by the Doughertys pursuant to the charitable pledge with TNC.
 - g. Did TNC market or offer for sale the Thompson Hill property to any persons other than the Doughertys. If so, please discuss in detail. In this regard, discuss the letter of TNC dated February 14, 2000, that stated that there were several interested conservation buyers to the Thompson Hill property. Were other buyers contacted about the property by TNC? Please provide any relevant documents relating to other buyers or any other offers.
 - h. If TNC did not actively market the property to potential purchasers other than the Doughertys, why did it fail to do so? Discuss in detail.
 - i. Was it TNC or the Doughertys that knew of the valuation expert and engaged his services for the appraisal of the conservation easement? Is there documentation that confirms or supports your answer?
 - j. Are there any other documents or other files in TNC's possession relating to conversation or correspondence that TNC had with Dougherty, especially regarding Dougherty's intentions to make a charitable contribution? Does TNC disagree with Dougherty's statements regarding his intent that were contained in the Post article? Please provide copies of the cancelled checks issued by Dougherty to TNC with respect to shi transaction.
5. Lake Huron Transaction. It appears that TNC's approach to the sale of property to Jerrold Jung of the land located in Mackinac County, Michigan, is different than some of the other conservation buyer transactions involving related parties. In Shelter Island, New York; Davis Mountains, Texas; and Gerrard County, Kentucky TNC received from each purchaser consideration from the sale and a charitable pledge or donation that was very roughly equivalent (in the aggregate) to the amount TNC paid for the acquisition of the property later transferred to the conservation buyer. In the sale to Jerrold Jung, the charitable donation of \$650,000 made to TNC plus the consideration from the sale of the property of \$1,062,000 paid to TNC was considerably less than TNC's purchase price to the property of \$2,277,730 allocated pro rata to the Jung portion of the transaction. Please comment. If you agree there is a difference in treatment, please explain why it was treated differently. To the best of TNC's knowledge, did _____ ever claim any charitable contribution deductions with respect to either the _____ or the _____ tracts? If so, what amounts and on what basis? What was

the total charitable contribution deduction claimed by Jung relating to the acquisition of the property from, and grant of conservation easement to, TNC (individually or through the trust), and describe whether it was cash or property? Please confirm that _____ did not claim a charitable contribution deduction with respect to his sale of property to TNC, despite TNC's letter to _____ saying it was a bargain sale and providing a blank Form 8283. Please confirm that to the best of TNC's knowledge, _____ claimed a charitable contribution deduction of \$98,700, the amount reported on the Form 8283.

6. Please provide a copy of the resolution or other written action dated June 13, 2003, supporting the Board of Governors decision that "all charitable gifts associated with a conservation buyer transaction must be legally documented as part of the transaction."
7. Please provide a schedule including the following information regarding CBP sales by TNC for each of TNC's 5 most recent fiscal years: aggregate sales proceeds for CBP sales closed during the year; aggregate charitable contributions received and pledged with respect to CBP sales closed during that year; aggregate of sales proceeds, charitable contributions, and pledges with respect to CBP sales closed during the year; aggregate FMV of conservation easements and conservation restrictions placed on CBP property sales closed during the year.
8. Please provide a list of lawyers, accountants, and other outside counsel who have provided tax opinions or other tax advice to TNC with respect to the tax consequences to TNC or other parties to TNC's CBP transactions (whether with respect to actual or hypothetical transactions); please provide a copy of such opinions and written advice.
9. Has TNC ever entered into agreements with buyers of conservation buyer program properties that TNC will indemnify or reimburse the buyer for lost tax benefits from the loss or reduction of the charitable contribution deduction claimed by the buyer?
10. Martha's Vineyard transaction: Please provide a narrative description of the Martha's Vineyard transaction, addressing all material aspects of the acquisition and disposition of the properties by TNC and the charitable deductions claimed with respect to these properties. In your narrative, identify all parties to the transaction, and describe their respective roles in the transaction. Also, identify and describe each material transactional document (e.g., purchase agreements, the tax indemnification agreement dated June 29, 2001, between TNC and HCAC). Further, discuss the Washington Post's description of the transaction in its May 6, 2003, article, and explain whether you agree or disagree with the Post's description of the transaction in that article.
11. Please provide the names and complete mailing addresses (most recent in your files) for each of the approximately 170 conservation buyers' program buyers for whom you previously provided documentation to the Senate Finance Committee.

II. Government— Transactions Regarding Land Sales

1. The TNC response to question 2 (of the July 16, 2003 letter) contains a summary of government transfers of \$500,000 or over which is supported by the more detailed list. What was the price paid by the government for each land transaction listed? Is the total of the “Land Cost Recovery” and the “Other Cost Recovery” columns under the “SALE” heading equal to the purchase price paid by the government?
2. With respect to the summary list described in the preceding question, identify and itemize the costs, in summary form, that make up the “Other Costs” column under the “PURCHASE” column. We are requesting a description of the costs generally, not a numerical calculation of each line item. Include in your answer a discussion of whether these costs consist only of tax basis costs (closing costs and land improvement costs) or also include annual maintenance costs such as taxes, insurance, maintenance, non capital improvements, and the like. Confirm that your answer is equally applicable to the “Other Costs of Acquisition and Disposition” column of the detailed Government Transfers list (not the Summary) provided in answer to question 2 of the July 16, 2003 letter.
3. Discuss generally whether TNC makes a profit on some of the land sale transactions with governments. For example, line item 35 on your summary list would seem to indicate that TNC made a profit of over \$1,300,000 on the sale. Discuss that transaction in detail including the appraised value of land at the time of acquisition of \$7,100,000 (being greater than the sale amount). Are there other transactions like this one, including state and local transactions as well as federal transactions of any size? If so, itemize each transaction providing the information previously requested for this question by the Committee.
4. Provide a new summary list adding to and modifying the existing list you provided. Modify the list to indicate under one column the purchase price paid by the government for the property. Also, on that same list, and consistent with your answer to question 2, above, provide detail of costs under the “Other Costs” column, separating tax basis costs from other types of costs, if applicable.
5. Based on your narrative answer to question II. 2 above, we understand that the amounts appearing under the “Amount Donated to Government” column are being reported in cost of goods sold. Is our understanding correct? Also indicate how the “Amount Donated” column was treated for financial statement purposes.
6. It is our understanding that the information provided on your lists in response to question 2 regarding land transfers to the government over \$500,000 represents only Federal transactions as so limited. We assume that amounts reported on Form 990, Part VII, line 93c also consists of other categories such as Federal transfers under \$500,000, state and local transfers, Indian tribal government transfers, or foreign government transfers. Please confirm

this understanding and discuss. Provide a breakdown of amounts reported on line 93c for each of the categories; Federal transfers under \$500,000, state and local transfers, Indian tribal government transfers, or foreign government transfers; for the three most recent 990s by TNC filed with the IRS and related cost of sales information.

7. Provide detailed information and numbers on the following transactions using exactly the same format as provided in your response to question 2 of our prior letter dated July 16, 2003, the detailed list titled "Government Transfers The Nature Conservancy – All Interests in Land Sold, Donated, or Exchanged from July 1, 1997 to June 30, 2002 to Federal Government Agencies \$500,000 or Over."
 - a. The 100 largest property dispositions (based on FMV of property transferred) by TNC of properties that were transferred to State and local governments (of the 7039 transactions reported on the schedules TNC has already provided).
 - b. If the following are not included in your response to the preceding question, provide similar information pertaining to Virginia Coast Reserve, VA (Nos. 416-420); Virginia Eastern Shore Megasite, VA (Nos. 421-423); Herring Creek Farms, MA (Nos. 604-607); Mashomack (Shelter Island), NY (Nos. 1027-28); Kentucky River Palisades, KY (Nos. 3617-3623); and Davis Mountains, TX (No. 5856). Is there any connection between the last four items and the conservation buyer transactions – related parties detailed in your answer to question 1 of the July 16, 2003 letter? If so, please discuss.
8. Provide aggregate information in the same format requested for the preceding question and a narrative summary of the project for each of the following projects listed in the sales to State and local governments: Big Cypress National Preserve, FL (Nos. 1465-1608); Big Cypress Preserve, FL (Nos. 1609-1638); Big Pine Key, FL (Nos. 1645-1816); Wisconsin Scientific and Natural Area Dedication, WI (Nos. 4582-4757); Lower Ozark Reserve Megasite, MO (Nos. 5263-5336). In addition, please provide all information in TNC's control or possession dealing with Big Cypress National Preserve and Big Cypress Preserve.
9. Why are land recoveries less than acquisition and transaction costs in so many cases, resulting in book losses from sales? Is there a potential concern that TNC paid too much for the land (e.g., from a related party) and couldn't recover the cost from the government?
10. Regarding the schedules previously provided for sales by TNC to Federal agencies (over \$500,000), please provide a description of each of the column headings in the Federal agency sale schedule.
11. How does TNC identify properties for sale to governments? Does the process differ depending upon whether the buyer is the Federal or a State/local government?

12. How does TNC identify government buyers for these properties? Are the identities of the government buyers generally known before TNC acquires the properties?
13. Is TNC provided Federal (including Fish and Wildlife Foundation), state or local government grants that are earmarked to acquire properties that are later sold to Federal, state or local governments?
14. Describe TNC's charitable mission in selling large tracts of land to government agencies. Include in your answer a discussion of whether the mission varies depending on whether the government is Federal, state or local government. Estimate the percentage of the land being sold that consists of property that may be described as serving a significant environmental or biodiversity purpose. Include in your discussion whether for each land transaction TNC has prepared a written report establishing such purpose. Indicate what portion of the government land sales consists of government requests prior to TNC's acquisition of the land, and what portion consists of property transfers not originally requested by the recipient government agency prior to the TNC acquisition. Do any of the transactions involve land that has primarily a recreational purpose? If so, do you consider that purpose coming within TNC's exempt purpose or activity?
15. Please provide a list of lawyers, accountants and other outside counsel who have provided tax opinions or other tax advice to TNC with respect to the tax consequences to TNC or other parties to government land sale program transactions (whether with respect to actual or hypothetical transactions); please provide a copy of such opinions or written advice.

III. Trade Land

1. Has TNC ever entered into agreements with donors of trade land properties that provided TNC will indemnify or reimburse the donor for lost tax benefits from the loss or reduction of the charitable contribution deduction claimed by the donor? If so, please provide a copy of each such agreement.
2. Why was revenue from the sale of trade lands reported on the 2001 Form 990, Part VII, line 93d, but no revenue was reported for sale of trade lands on that same line for Form 990 for 1996 through 2000.
3. Please provide a list of lawyers, accountants and other outside counsel who have provided tax opinions or other tax advice to TNC with respect to the tax consequences to TNC or other parties to trade land program transactions (whether with respect to actual or hypothetical transactions); please provide a copy of such opinions or written advice.

IV. Loans

V. Internal Reports, Audits, and Studies**VI. Easements**

1. State the number of conservation easements held by your organization as of December 31, 2003. As of December 31, 1993.

2. Is there on file with your organization a copy of each deed or other legal document that grants or establishes the conservation easement granted in favor of TNC? If so, describe how they are maintained. For example, is there a central file or are the files held in local offices? Are there any properties for which a copy of the conservation easement deed is missing or not immediately available to TNC? If so, state how many.

3. State in detail your practices, policies, and procedures for monitoring landowner compliance with the terms of an easement granted to TNC. Include in your answer how frequently you inspect the property or contact the landowner. Does your policy on monitoring the easement vary with respect to the size of the property subject to easement or the importance of the easement for conservation of the environment? Attach copies of TNC reports to monitor conservation easements for the ten largest and the ten smallest conservation easement properties in each of Ohio and California since 1998.

4. State how often TNC has engaged in litigation to enforce a conservation easement granted to it over the past ten years. For each such instance, describe the litigation briefly and discuss the outcome of such litigation.

5. Does TNC have a written policy or a general rule of thumb (written or unwritten) regarding when it will engage in litigation to enforce a conservation easement granted to it? If so, please attach a copy of the written policy, or describe any unwritten policy.

6. Explain the practices, policies, and procedures of TNC for granting a modification or amendment of a conservation easement held by or for the benefit of TNC? If there is a written policy, please attach a copy.

7. The easement modification chart submitted December 11, 2003, suggests that a number of conservation easement amendments or modifications would appear to benefit the landowner. Please describe in detail the easement adjustments provided for items 3, 4, 5, 6, 7, 8, 13, 14, 19, 20, 21, 26, 28, 29, 39, 44, 51, 56, 60, 61, 64, 65, 67, 70, and 74 of such chart. Discuss how TNC views such modifications as either benefiting or not benefiting the landowner. For each item, attach a copy of the easement before amendment and a copy of the easement after amendment, and provide a narrative discussion of the changes made.

8. Does TNC monitor and record changes in ownership of property subject to conservation easements granted in favor of TNC? If so, does TNC contact the new owner by letter or otherwise and impress upon such owner the obligations under the conservation easement? Please attach a copy of (a) any recorded effort to track such changes in ownership, and (b) any notice to new owners regarding easement obligations.

9. Please respond to assertions or concerns regarding conservation easements as follows: (i) How many easements has TNC written off as unenforceable or of little value? (ii) Please provide a list of any such write-offs including the name of the owner of the property subject to the easement and the location of the property. (iii) Does TNC fail to enforce easements where it is aware of violations because of the cost of litigation relative to the worth of the easement in question? Please discuss your answer. (iv) Is TNC concerned that over time, with change in ownership, new owners not having conservation goals may violate easements in large numbers? Please discuss. (v) How does TNC defend its conservation easements on small tracts (from less than one acre to up to 2 or 3 acres) where monitoring and enforcement of easements is more difficult economically? Please discuss.

10. Regarding the 78 transactions exceeding \$1 million for fiscal years 1998 through 2002, how many of these were (1) purchases at fair market value, (2) bargain purchases, and (3) donations? Please identify each of the 78 transactions as being in one of these three categories.

11. Please provide supporting Forms 8283, and where applicable, Forms 8282, for these 78 transactions.

12. Does TNC use easement valuations to minimize book losses, or enhance book gains? Please explain how TNC's financial statement treatment with respect to valuation of easements (whether acquired by purchase or by donation, or by other means such as by TNC creating the easement as a part of an acquisition or disposition of property by TNC) complies with accounting standards applicable to TNC and to nonprofit conservation organizations.

13. Please provide documentation to support TNC's statement that it has advised donors in writing "that the donor's proposed claim for that value may be excessive" if "TNC is made aware" the donor's proposed claim of FMV is "clearly and significantly in excess of what would seem to be a reasonable value." Please provide copies of all such letters sent within the last five years.

14. Please provide the names and complete mailing addresses (most recent in your files) for each of the first 50 persons who contributed conservation easements to TNC during calendar years 1999, 2001, and 2003.

15. Your response to our letter of July 16, 2003, included a chart of "Conservation Easement Purchases and Donations" greater than \$1 million. Item 14 of the chart lists a site name of "San Joaquin Hills Portfolio" with a listed fair market value of the easement of \$2,016,100. Item 15 of the

chart, the same site, lists a fair market value of the easement of \$16,376,300. Item 16, the same site, lists the fair market value of \$17,685,000. Item 17, the same site, list the fair market value of the easement as \$89,415,400. All four easements were provided by the same company. As to all four items please provide all information in your files relating to these transactions including, but not limited to, appraisals, identification of the grantor, identification of the property, the charitable donation claimed, a copy of forms 8283, copy of deeds, copy of e-mail, letters, memos, and provide a narrative description of the transfers and the environmental purpose and significance of the property.

16. An example of a small conservation easement is the conservation easement placed on 1.62 acres on land transferred to _____ with respect to New Mexico – Santa Fe Canyon Preserve. Is an easement appropriate since the _____ were encroaching on the land? How much of the driveway and fence were an encroachment on the land? Could TNC have sold a sliver of land outright that covered the area of encroachment? Does this easement serve a conservation goal?

17. Please provide a list of lawyers, accountants and other outside counsel who have provided tax opinions or other tax advice to TNC with respect to the tax consequences to TNC or other parties regarding the acquisition or granting by TNC of conservation easements or similar conservation restrictions (whether with respect to actual or hypothetical transactions); please provide a copy of such opinions or written advice.

- VII. Board Membership and Organization**
- VIII. Executive Compensation**
- IX. President’s Discretionary Fund**
- X. Major Donations, Sales, Exchanges of Land**
- XI. Valuation**

Please provide copies of documentation to support TNC’s statement that “TNC has given the donor notification in writing as part of the Form 8283 that there are serious concerns with the donor’s valuation.” Please provide copies of all such letters sent within the last 5 years.

- XII. Related Organizations**

1. The Report to Management for the year ended June 30, 2002, states that in several instances, separately created legal entities or relationships that may be controlled by TNC were created without the prior approval of the Headquarters Office, in violation of the organization's policies and procedures. Please provide any documentation pertaining to your response or follow-up to the recommendation made in the Report to Management for the year ended June 30, 2002, that you "enforce policies and procedures for identifying related parties, monitoring the status of the relationships, and receiving current financial information to properly account for these entities."

2. Conservation Beef, LLC (CBL):

- a. Please provide the LLC's organizational documents including agreements, and all amendments thereto.
- b. Explain the parties' agreement regarding capital, profit, and loss allocations. Why is TNC only a 50% owner of capital, profits and losses, when to date it has contributed 72% of the capital to CBL? Why hasn't AWF made any capital contributions to CBL since 2000?
- c. Please provide a copy of the IRS determination letter for AWF.
- d. Please provide a copy of AWF's most recent Form 990.
- e. How did you select AWF as your co-venturer for this project?
- f. For fiscal year ended 2000, line 20 other deductions on Form 1065, explain "loss allocation to exempt purposes" in the amount of \$372,512.
- g. Please provide a copy of CBL's 2003 Form 1065, when available. Please provide copies of CBL's financial statements for 1999 through 2002.
- h. Who are the participants in CBL's retirement plan? Why did contributions to the plan increase from \$8,661 in 2000 to \$16,387 in 2002?
- i. Who provided the \$40,000 loan to CBL in 2002? Was TNC a lender or guarantor?
- j. Explain in detail the LLC's activities and mission, and explain how they substantially further TNC's exempt purposes.
- k. The article in the Washington Post describes the use of the brand name "Conservation Beef" by TNC, a brand name that is co-owned by TNC and the Artemis Wildlife Foundation. The Post article provides, in part that the program was used to bolster imperiled cattle ranches, and, along the way, entice ranchers into environmentally friendly grazing practices.
 - Provide a general description of the Program involving use of the brand name "Conservation Beef." Include in your answer whether TNC realized any profit or loss from this program for the period beginning in 1999, and if so, how much profit or loss was realized each year?

- Attach copies of the contracts with all interested parties such as, the ranchers, the co-owner(s), the marketing agent. Attach copies of financial reports beginning with 1999.
- How did TNC report its distributable share of losses from this program or entity on its Form 990 or 990T for the years beginning in 1999?

3. Nature Serve (Formerly the Association for Biodiversity Information) (ABI):

- a. Please provide a copy of the July 1, 1999, agreement between ABI and TNC, and any subsequent amendments thereto.
- b. Please provide a copy of ABI's governing instruments and organizational documents, and amendments thereto.
- c. Please provide a copy of ABI's determination letter.
- d. Did TNC report its fee income from its ABI agreement dated July 1, 1999, as unrelated business income? If not, why not?
- e. Please provide a copy of the TNC line of credit arrangement with ABI (see note 2 of the 2000 financial statements).
- f. Explain how TNC's agreement with ABI substantially furthers TNC's exempt purposes.
- g. What was the purpose of TNC's contributions to ABI in the annual amounts of \$966,264; \$5,395,311; and \$4,690,800 for 1999, 2000, and 2001, respectively?
- h. Why did the organization respond to Questions 84a and 84b as "N/A" in its Forms 990s (regarding soliciting contributions)?
- i. Describe any affiliations with the independent contractors listed on Schedule A of Form 990, and specific information regarding the nature of services rendered by the contractors.
- j. Why did the number of employees increase from 4 in 1999 to 91 in 2000?
- k. Explain why the data base service fees received in 2000 (\$75,488) and 2001 (\$168,191) are not unrelated business income to ABI? NOTE: Required explanation was not provided on Form 990, Part VIII Schedule for 2000 or 2001.
- l. Provide a copy of the organization's financial statement for 2002.

4. Eastern Shore Enterprises, LLC

- a. Certain persons other than TNC received profits or capital interests in Eastern Shore Enterprises LLC. Describe the terms and conditions under which the following persons received LLC interests, and explain whether such persons were

treated by the LLC as having received a partnership capital or profits interest other than in a tax-free transaction: _____.

- b. Did any other persons ever hold interests in the LLC?
 - c. Please provide copies of any agreements relating to the acquisition by _____ of LLC interests.
 - d. Please provide corrected partnership profit, loss, and capital percentage information for 1999 (K-1s total to more than 100% capital interests).
 - e. Provide detail of “other deductions” for each of 2000 through 2002; there is no breakdown in the return.
 - f. Describe the relationship between Eastern Shore Enterprises LLC and Virginia Eastern Shore Sustainable Development Corporation, beginning with the LLC’s formation.
 - g. Did any members other than TNC ever make capital contributions to the LLC?
5. Virginia Eastern Shore Sustainable Development Corporation (VESC)

- a. Who were the eight shareholders of VESC, and what were their respective holdings at all times they were shareholders? Who was offered an opportunity to participate as a shareholder of VESC?
- b. Please provide copies all shareholder agreements, subscription agreements, and organizational instruments, including amendments thereto.
- c. Who provided shareholder capital to the corporation and at what times and amounts?
- d. Please provide copies of the loan documents pertaining to the corporation’s long-term debt, and describe the organization’s relationships with the following lenders, The Ford Foundation, the Mary Flagler Cary Charitable Trust, and the Lincoln-Lane Foundation.
- e. Please provide copies of any royalty agreements pursuant to which the organization incurred royalty expenses.
- f. Please provide copies of Forms 1120 for 1995 through 1997.
- g. Please provide a copy of any notes receivable from TNC as obligor, to the corporation, as holder (e.g., \$80,000 relating to the Mill Creek Farm land transaction). Confirm all debt owed by TNC was paid on or before the corporation’s liquidation in late 1999 and early 2000.
- h. Describe the corporation’s “investment in Waterside Capital” in the amount of \$50,000. Describe any relationship between TNC or VESC and Waterside Capital and its principals.
- i. Please provide a list of shareholder capital contributions by date, shareholder, and amount, from 1995 through 1999. Describe any corresponding changes in shareholder ownership percentages.
- j. The 1999 Form 1120 reports debt forgiveness income of \$798,775. Who held the debt, and describe the negotiations that took place to ultimately cancel the debt without repayment.
- k. Describe the corporation’s investments in real estate.

- l. State which shareholders were Class A and Class B shareholders. Describe the differences in rights and obligations between the two classes.
 - m. What was TNC's role in organizing the corporation?
 - n. Please provide a copy of the corporation's Board resolution dated October 1999 to liquidate the company.
6. Adirondack Land Trust (ALT)
- a. Please provide a copy of the Memorandum of Understanding dated October 3, 1988, between TNC and ALT, and any amendments thereto. Why did TNC enter into this arrangement, and why does it continue to be involved in this relationship?
 - b. Why are all ALT employees also employees of TNC?
7. STN/TNC LLC (STM)
- a. Describe the purposes and activities of STM from its inception in 1993 through the present.
 - b. STM has two members: TNC (34.6762%), and Sumner T. McKnight Foundation (65.3238%). What is the relationship between TNC and the McKnight Foundation?
 - c. Explain STM's relationship to the Virginia East Coast Sustainable Development Corporation or its projects.
8. The Forest Bank, LLC
- a. Please provide a copy of the LLC's Board resolution authorizing liquidation of the LLC, and information regarding the payment of liabilities and the distribution of the LLC's assets upon liquidation.
 - b. Please provide a copy of the SEC registration materials pertaining to registration of the LLC's membership interests with the SEC.
 - c. Please provide a copy of the organization's organizational documents and governing instruments, including amendments thereto.
 - d. Please provide a copy of any subscription agreements or materials pertaining to the LLC membership interests.
 - e. Why was the LLC organized in 2001?
 - f. Why was the LLC liquidated in November 2002?
 - g. Please provide a description of the LLC's legal expenses of \$186,272.88 in 2001.
 - h. The 2001 Form K-1 lists TNC as the 100% owner. Why did TNC and the LLC take the position that this was a partnership for Federal income tax purposes, rather than an association taxable as a corporation or a disregarded entity?
9. Please provide a list of lawyers, accountants, and other outside counsel who have provided tax opinions or other tax advice to TNC with respect to the tax consequences to TNC or other parties

regarding TNC's relationships with, and activities conducted by, TNC's related organizations; please provide a copy of such opinions or written advice.

VIII. Travel, Conferences, Meetings, and Other

XIV. Transactions with Board Members

1. Discuss in detail all the land and service transactions between TNC and Georgia Pacific Corp., International Paper Co., and Orvis Services Co., or their subsidiaries, while an executive of these companies sat on TNC's Board of Governors or Leadership Council. In discussing your answer, include the following:

- a. Identify the period that the executive of each company sat on the TNC Board of Governors or Leadership Council.
- b. Identify each particular transaction with each company in a gross amount of over \$200,000.
- c. State whether TNC realized a gain or a loss on each transaction with such companies identified in your answer to the preceding question.
- d. Describe TNC's Leadership Council and discuss its official function with TNC.

2. Identify similar large transactions with other corporations having an executive serving of TNC's Board of Governors at the time of the transaction, beginning in 1998 to the present.

3. Please 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 interests 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; please provide a copy of such opinions or written advice.

XV. Conservation – Texas Oil and Gas Drilling

XVI. Litigation

XVII. Grants

XVIII. Cash Donations Greater than \$50,000: Individual donors from whom TNC has purchased land or interests in land, from FY 98 through FY 2002

Has TNC ever entered into agreements with donors that provided TNC will indemnify or reimburse the donor for lost tax benefits from the loss or reduction of the charitable

contribution deduction claimed by the donor? If so, please provide a copy of each such agreement.

New Questions:

The following questions are new questions generated by the Finance Committee investigation of TNC to date.

I. Functionally Related Revenue

1. List each specific and separate activity or program that generates program service revenue under the broad heading “Activity Fees,” “Contract Fees,” and “Fees and Contracts from Government Agencies.” (from statement 23 attached to TNC’s Form 990 for 2000 and 2001). Then, as to each item, explain in detail why such revenue is characterized as “Related or exempt function income.” Include in your answer a description of the types of services provided by TNC to other parties. Explain how TNC complies with the instructions to Form 990 for completion of Part VII and Part VIII of its Form 990 for 2001 and earlier years in that statement 23 failed to provide detail for each specific type of revenue received and failed to itemize the specific types of revenue. See 990 instructions, the example under Part VIII, page 32.

2. Please provide a list of lawyers, accountants and other outside counsel who have provided tax opinions or other tax advice to TNC with respect to the tax consequences to TNC or other parties regarding the activities described in the immediately preceding question (whether with respect to actual or hypothetical transactions); please provide a copy of such opinions or written advice.

3. Discuss whether for-profit businesses engage in some of the same activities as described in response to the preceding question 4. In particular, address your answer to activities under 93b and 93g of statement 23 attached to Form 990 for 2001.

II. Other Questions Regarding Revenues, Expenses and Form 990 Reported Items

1. The fiscal years 1992 through 1994 report no revenues from government contracts. Please explain what happened in 1995 that caused TNC to begin reporting government contract revenues.

2. Explain the Form 990 (2001) Statement 24 explanation regarding Cisco Systems, Inc./Mr. Morgridge transactions, and how the arrangement resulted in a 76% discount to TNC.

3. Explain TNC’s arrangement with General Motors described in the Form 990 (2001) Statement 24, p. 2 of 2, regarding the greenhouse gas mitigation offsets. Please provide a copy of TNC’s agreement with General Motors.

4. Please describe the “insurance proceeds” revenues reported as other revenues on Form 990, Part VII, line 103, and the basis for exclusion from UBI.

5. Please demonstrate how the tax-exempt bond financings reported on Statement 15 comply, and have at all times complied, with the Federal tax-exempt bond laws.

6. Provide a description of the contribution of the conservation easement by SMI to TNC that is reported on Schedule 24, Form 990 (2000), with regard to Mr. Ian Cumming.

III. Excess Benefit Transaction Issues

1. You stated in your answer to question 8 of our prior letter that the Board of Governors approves the compensation recommendation for the President/CEO in the January meeting. Since the compensation is effective for January 1, the compensation arrangement is not approved “in advance” (Reg. 53.4958-6T(a)(1)). Please comment. Attach copies of the minutes of January Board of Governors meetings approving the compensation of the President/CEO for the prior three years.

2. Were any loans made to any TNC officers, employees, or members of the Board of Governors treated as an economic benefit to the recipient as consideration for the performance of services where TNC clearly indicated its intent to treat the benefit as compensation within the meaning of section 53.4958-4T(c) of the regulations? If so, please discuss in detail and provide supporting documents.

3. In connection with your response to question 4 of our prior letter, state the title and salary of _____ and indicate your view as to whether he is treated as a “disqualified person” within the meaning of section 53.4958-3T of the regulations. Provide a narrative discussion of the details of the shared appreciation note and attach a copy. Indicate the value of the property on purchase and attach a copy of the appraisal. Provide the employment contract and correspondence and other communications or memos describing his salary and job description.

4. TNC’s Internal Auditors Report as of November 30, 2001, with a release date of February 27, 2002 (“Report”), discusses, on page 4, two independent contractors who may be more appropriately treated as employees of TNC. The Report further indicated that one of the contractors received payments from TNC over 11 months totaling \$350,000 and that the contractor, if deemed an “employee” by the IRS would qualify as an “insider” by virtue of her position with TNC. (a) Identify the person; (b) state how long she has been associated with TNC and whether she continues to be associated with TNC as a contractor or employee; (c) indicate the period during which she served as a “contractor” with TNC; (d) state the amount of payments made to her over this period; (e) describe her duties, responsibilities and obligations to TNC in detail under the “contract” with TNC; (e) attach a copy of the contract(s) between her and TNC; and (f) attach all correspondence and other communication or memos relating to her relationship to TNC as a contractor or as an

employee, including letters relating to her continued retention with TNC as either an employee or contractor as well as her termination.

5. a. Further, with respect to the “Report” described in the preceding question, comment on the assertions in the Report that, if deemed as an employee, she would qualify as an “insider” and her compensation could be viewed as excessive, thus possibly violating intermediate sanctions rules. b. Rev. Rul. 87-41, 1987-1 C.B. 296, provides a discussion of the employee – independent contractor issue. The Ruling lists 20 factors to be taken into consideration. Discuss each factor in connection with the “contractor” that is the subject of the preceding question. In addition to or as part of your answer to the preceding questions, please address the following: It is our understanding that she performed her work at TNC’s headquarters in Arlington, Virginia. Further, it is our understanding that her activities on behalf of TNC included hiring and supervising employees. It is our understanding that she not only had a long-term relationship with TNC as a contractor but she also had previously been an employee of TNC. Please comment and discuss in detail. c. Please provide all information in TNC’s possession regarding this audit particularly in regards to filings with the IRS. d. Please explain in detail what actions TNC’s board took in response to this audit. e. Please explain the employment history of this individual. Specifically, the timing and amount of payments made to this individual either directly or indirectly after the audit.

6. Submit a copy of the promissory note and mortgage signed by Mr. McCormick with respect to the loan to him by TNC dated May 22, 2002.

7. Did Mr. McCormick report the TNC loan to him as income on his Form 1040 prior to the commencement of an IRS examination of TNC?

8. Please provide a list of lawyers, accountants, and other outside counsel who have provided tax opinions or other tax advice to TNC with respect to the tax consequences to TNC or other parties regarding private benefit, private inurement, or excess benefit transaction tax issues (whether with respect to actual or hypothetical transactions); please provide a copy of such opinions or written advice.

Thank you for your time and assistance on this matter. We would ask that the answers be provided in thirty days.

Cordially yours,

Charles E. Grassley
Chairman

Max Baucus
Ranking Member