

# Patterson Belknap Webb & Tyler LLP

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*What follows are the May 8 comments of Tomer J. Inbar, Patterson Belknap Webb & Tyler LLP, New York, and Lois R. DeBacker, Kresge Foundation, Troy, Michigan, as delivered to members of the EO Committee of the ABA's Tax Section. The moderator of the panel is David Shevlin, Simpson Thacher & Bartlett LLP, New York.*

**Shevlin:** Good afternoon, everyone. Welcome to the afternoon sessions of the Exempt Organizations Committee. We're going to get started now on our first panel. I'm David Shevlin with Simpson Thacher & Bartlett in New York. To my immediate right is Tomer Inbar with Patterson Belknap Webb & Tyler in New York. And to Tomer's right is Lois DeBacker who is the managing director and head of the environmental program at the Kresge Foundation from Troy, Michigan.

We are going to spend the next hour talking about the environment, but a couple of acknowledgements first. You have two outlines in your materials for today's panel and I want to acknowledge and thank Leila Vaughan from the Chamberlain Law Group -- I'm not going to say all the names of that firm because I can't pronounce them -- in Pennsylvania who helped us and who prepared an outline for today's panel as well as the Environmental Law Clinic at Columbia University that allowed us to include their draft working paper as part of your materials. It is very exciting to have the law students participate in the preparation for this panel, and so I want to thank Tomer for facilitating that.

How has philanthropic participation in the environment evolved over time? And how has that matched where we are from a regulatory perspective? Obviously, climate change, energy efficiency, as part of the environmental consciousness, is extremely important in all facets of our society, so what is the exempt sector's role and how does it match with the law? And that's the thesis of what we're going to be spending much of the next hour speaking about, including touching on perhaps some international issues facing charities that are involved in the environmental cause and otherwise.

How we're going to proceed is Tomer's going to first sort of set the table, if you will, using his own words and giving us a sense of the evolution from a regulatory perspective of where we are on these issues. Lois is then going to speak from her perspective on the imperative of the philanthropic participation in the environmental cause and climate change and energy efficiency and we'll talk also about some of the, maybe, specific PRI perspective, but it will not be a PRI panel. We'll be speaking about the role that PRIs are beginning to play for philanthropy in this area as well.

So, without further adieu, I will hand it over to you, Tomer.

**Inbar:** Thank you. When Dave and I started talking about this panel, I think we had just had lunch and weren't talking about the panel and then we realized we needed to talk about the panel and we were on a street corner in Manhattan and we said "wouldn't it be great to do a panel on this?" And then we said, "wouldn't it be great to hear from the foundation side, and why they care so much about this?"

So rather than just having us as lawyers come up and say, "here's what the law says, here's what we're seeing, here's our compliance challenges" -- what's happening on the foundation side where foundations are grappling with the importance of climate change, the importance of environmental preservation and conservation, and developing programs on both the grant-making side, the PRI side, the technical assistance side, that are really moving beyond, in many ways, what the law might be saying.

And then, how does that come back together as we're advising clients and having conversations with folks like Lois as she's developing her program, who come to folks like us and ask "I'd like to do this, is this consistent or is this too aggressive or is it not aggressive?" And then how do we navigate those tensions sometimes?

And so we thought it would be really great -- and that's why I'm really happy that Lois was able to do this because I think it's going to be nice to have in between the conversation about the law per se, having questions of why we really need to do this and what we should be thinking about as the community grows and the regulations and how the IRS thinks about this in a different way.

What I want to do is, as Dave said, just set the table a little for this, walking through what I think is an interesting evolution to the treatment of environmental conservation or the environment as a charitable factor. I want to focus on the evolution of the IRS approach to this and as we see sort of a greater skepticism and an interesting approach as the market, whether it be on the charitable side or the for-profit side, starts developing things that are meant to address some of the things we care about in the environmental space.

And so then the question I ask myself, are these concerns that I have real, in the sense that when I look at some of the rulings coming out and start to worry about what would this language mean in the ruling -- do they really mean to say that, or did they really mean that? Or, is it more a reaction to what's happening generally across the nonprofit sector where we see commerciality -- not using the commerciality doctrine thing -- but commerciality, or people looking to the market and market mechanisms to actually address problems that might go beyond traditionally what charities were focused on.

Part of the difficulty, I think, is that there's a bit of uncertainty as many of the things we're doing focuses in areas that haven't been focused on before, the problems seem bigger than some of the narrower problems that were being addressed in some of the earlier rulings, and so, thinking that through and how that plays out, when we go back to what we care about, the notion of what is charitable here, and how do we determine what is charitable?

So, at a basic level, as probably many in the room know, environmental conservation or the environment is not enumerated in 501(c)(3). It's not one of the things that we think about when we do our litany of 501(c)(3) things. When you look back and when we think about it, it comes out of generally accepted principles of charity. What is charitable? And the mantra that many of use, a mantra I use with my clients, is that it includes protection and preservation of the natural environment (for the public benefit). When I think about that, that's how I've evolved into saying it.

When I find myself, as we all do, sort of falling into these patterns of, you know, answer the question, here's the mantra. But when we think about the environment or environmental conservation, there are lots of different things we think about. We think about conservation, we think about protection, we think about education, we think about advocacy, beautification, recreation, public use and enjoyment, health, planning, litigation, and prevention of degradation.

And so, it picks up a lot of different things in one little bucket, and when we think about going back over time, when it started to come out, the environment was always tacked on to something else. We always had to find something else to find that something in the environmental space was good.

And so we have this pre-1976 focus -- you look at some of the revenue rulings and there are tons of revenue rulings, like every other day a revenue ruling was coming out. I don't think we have that many revenue rulings coming out any more, but it was fascinating going back and looking at how much of this law was coming in in revenue rulings.

And so we have community recreation facilities and -- oh, by the way there was an environmental component to it. Education and -- oh, by the way there was an environmental component to it. Land use, city beautification and planning, recycling, lessening urban blight. So when we think about the law coming out in the earlier days, the law was coming out with environmental as a corollary to something else that was that was recognized as charitable happening. It was interesting because you always had to find that hook.

I think, when we talk a little later in the hour, in a lot of ways some of us have evolved to going back to that place because of where some of our clients are in wanting to do things that might not necessarily have the greatest precedent in the law if they need us to look at it for them. So, it's going back to tethering some of the environmental stuff back to lessening the burdens of government or back to the community vitalization and so on and so forth.

This focus begins to change in the seventies with Revenue Ruling 76-204 where that revenue ruling, and it's interesting reading some of the words from there, because it was like someone got their hands on it, and they felt, you know, this is the moment and we're going to say lots of great stuff about the environment here. And so in that one it was the preservation of ecologically significant "land" regardless of whether there is public access or recreation or even enjoyment or any education; as long as the land was ecologically significant, it was worth protecting.

The three quotes that I want to read are very instructive in that the IRS said, at this point, out of nowhere: "It is generally recognized that efforts to preserve and protect the national environment for the benefit of the public serve a charitable purpose." And then: "The benefit to the public from environmental conservation derives not merely from educational, scientific and recreational uses that are made of our natural resources, but from their preservation as well. . . . an equally important public purpose is served by preserving natural resources for future generations."

So, suddenly, from this continuum, we get this statement that environmental preservation and conservation in its own right is important, necessary and something we should pursue. There were a few rulings that came out after that, and one ruling that sort of dialed it back a little and said it has to be ecologically significant -- don't forget, we don't want you saying having a farm, farming it, and saying since I'm not doing damage, this is great. And so we had a ruling that came out and said this, that sort of brings us back to this notion that there has to be some ecological significance to it.

We then have the *Dumaine Farms* case [73 T.C. 650] that comes out two years later in 1980 that talks about -- for many of us, at least for me, I use *Dumaine Farms* a lot for this notion of a demonstration project. But at the heart of it, there are people who look at it as an environmental moment, that it's about an experimental farm, it's about experimental farming techniques, but at the heart of it, the question of what it was showing and what it was doing was about education, science and so on and so forth so that put another limit in this area.

**Shevlin:** That's interesting, because in the revenue ruling from 1978 that dialed it back a little bit, I think the concern was that it involved farmland that didn't have an inherent ecological significance to it. But what *Dumaine* did, it seemed to me, was to say, notwithstanding the fact that the property itself may not be inherently and ecologically significant, we're going to be doing things with this land that are going to have benefits beyond this piece of property itself. Is that, is that the way that you it?

**Inbar:** I think that's right. I think you both have the notion that what we do here is really significant and important and what we did in that case had an environmental component to it. But that allowed the IRS, when it looks at *Dumaine*, to say, "well, that's about education, that's about science, it's about this," we weren't really attacking or getting to the notion of environment there.

So, if you simply were going to -- if I was going to simply, as most of us in Brooklyn now do, put a farm in my backyard and raise chickens and do other things -- if I was going to do that, simply doing that in and of itself wouldn't necessarily be charitable except those of us who are from Brooklyn and very smug about it think that preserving Brooklyn is a very charitable activity.

**Shevlin:** Well, and we from Manhattan go and we buy the chickens from that farm you have.

**Inbar:** Just to keep the ball rolling here because I want to make sure that we get enough of a conversation, you also have in 1980 section 170(h) come in, you have the notion of qualified conservation contributions which focus another place within the Code and within our consciousness as charity lawyers on things that are charitable in the conservation and the environmental space.

So now there's this kind of weird quiet period where we hum along and everything seems to be going nicely. We get the Terra Capital ruling that comes out about the investment in an investment fund, which is -- I remember when it came out wondering why anyone would even get a ruling for that, except that the ostensible reason was because they were paying high returns as opposed to wondering whether it was okay to invest in an international investment fund focused on preserving ecologically significant properties -- land -- throughout the world. If we flipped it now, people would be look at -- I always wonder whether that ruling could be had in this day and age -- but going back and looking at that ruling, it's a great ruling except it's got all the right language in terms of all the good science, all the good approach to the environment, all the things that are kind of ring fenced the idea that we would not have good charity here.

And so, in thinking about it, reading back on that ruling, I ask myself the question which I think is going to be a theme after we finish with Lois's piece, would we have been able to make a PRI or would we be able to make a PRI into any of the businesses that fund was doing now? They talk about ecotourism and thinking about would it be a good PRI, for example. And I know we hear PRI over and over again, but just from the dichotomy of exemption versus PRI is something that I just want to set out here, because I think that's an important one as we look to some of the later rulings that are either revoking exempt status or are denying exemption. So, thinking about that, this notion of, could a foundation or could someone have invested in these activities as a good, charitable activity.

**Shevlin:** That's an important bookmark that we'll come back to. The ruling for those of you unfamiliar again is the Terra Capital ruling, and it's an important one because, like Tomer said, things were kind of humming along and then this came along and so we're beginning to get into more of the modern age of regulatory thinking.

**Inbar:** Right, and then the landscape starts to shift a bit. We fast forward until about 2010 when we see a couple of rulings that are pretty creative. There's lots of stuff going on in them and the IRS is taking pains in these rulings to show us all of the lots of stuff that's going on, and that lots of stuff tends to be bad stuff. At the heart of the activity, though, are things that are interesting from a conservation standpoint, and so we have this weird nexus of private benefit, commerciality, and not readily apparent cause and effect with respect to the environment happening.

These are things that are in the community, sort of in the ballpark of what we would care about from the environmental standpoint, but we're not sort of dredging a river, or we're not going ahead and putting aside land or we're not stopping peat fields from spontaneously combusting in Indonesia. What we're doing is, there's something in the works that relates to what we care about, but it's not the thing that is directly addressing the problem.

We start seeing this notion of direct versus indirect. The language creeps up in weird ways in a couple of the rulings, but it does come out. So, in 2010, we have an adverse determination for an organization formed to promote the

reduction of greenhouse gasses and carbon emissions and encouraging green construction by providing down payment assistance to low and moderate income families. So, now that's the facts -- but, how do we get there?

The first part seems great. Love it. But then we get to this down payment assistance, so now we've got the hook. There's no way we're giving this ruling the exemption because of low and moderate. So, let's say we got rid of the moderate. Maybe we could've done it. But then we're back to the earlier days where the only reason it's happening is because of low income.

But the premise at the start was there seems to be a problem somewhere that we're not having people -- we're not building these homes that are in a way that would ultimately be LEED certified -- we're not building things, we're not putting into the pipeline of our society things that are important. And the way this organization felt you got there was low and moderate people need homes, they're the ones who probably could least afford to buy a LEED certified house, let's give them assistance to do it and if we can create a market for that, that might change the game.

But that one was denied, and the IRS said it distinguished that organization -- I'm going to quote here -- "from one that provides a specific, direct environmental benefit to the public such as planting trees to combat community deterioration, providing information on recycling and acquiring and preserving ecologically significant land." So, we start to see this contrast, that there's a way to directly promote protecting and preserving the environment and there's indirect things that bled into other things that we don't like, like private benefit, commerciality, etc.

In 2012, there was a revocation -- and Dave will talk more about this one. It was a supporting organization established to have incentive programs using carbon offset credits. The IRS determined that the organization's activities were non-exempt commercial activities, namely, the establishment of an infrastructure for trading carbon offsets.

What's interesting about it -- this is a revocation, so it got through the IRS with this purpose. The exemption application said that the primary charitable program was the development of incentive programs using carbon offset credits to corporations and other large polluters to fund environmental projects that will result in the replacement of forests and other similar natural resources that assist in cleansing the greenhouse gasses produced by carbon emissions. That was in the exemption application that got through, that was granted exemption.

When they were audited later on, if you read the PLR, it's 30 pages -- everything is wrong in it. I don't think this organization could have ever found the keys, they didn't do anything right. And when you read it, you wonder how much of that was real, and how much was that the IRS looking to find total private benefit everywhere it looked. There was private benefit, like, under the table; there was private benefit coming out of the curtains; but that was what was happening in that ruling. I think Dave will talk a little more about it, because I think at this time we're starting to see some of our clients actually looking at these organizations to provide PRIs to them and thinking of these as charitable activities.

2012 was a banner year for this by the way -- there was an organization formed to provide residential solar energy systems to low and middle income households. Why everybody goes in with middle income anymore, because anytime the IRS sees middle income in anything that's not, you know, right on point saying it's charitable, they find a way to get it out of there for the middle income. But this is the one that gives us a lot of pause for a couple reasons.

The IRS first determined that they did not serve the charitable class. The IRS then went into all the private benefit associated with it. But then, in kind of a gratuitous paragraph that didn't need to be in there, because they'd already found that this organization was not going to get exemption, they addressed the environmental impacts of putting

solar panels on people's homes. And they compared these to the organizations we discussed in the beginning that were doing directly charitable stuff like planting trees and making the lake fresh and happy for the people who live around it, and what they said is that those organizations are different because they provided a direct environmental benefit to the public as a result of their activities:

"The environmental benefits of your activities would be indirect and tangential. You have provided no credible studies or research to show that use of your particular solar systems would have a measurable or significant impact in preserving and protecting the environment."

When I first read that, I was wondering which solar systems I was in, and which solar systems this was directed at, but when I got past that, what was problematic there was that suddenly separate from the private benefit and giving money to people to put things on their roofs and things like that, there was a statement about the environmental efficacy of solar panels. And that notion of direct and indirect, that notion that simply putting a solar panel on my house, simply buying a refrigerator or giving someone who wouldn't ordinarily go out and buy a more energy efficient refrigerator, giving them the means to do that, that did not have any direct, tangible, significant impact on the natural environment.

The last one I'm going to talk about, just because 2012 was a banner year for this, was an organization that purchased carbon offsets from commercial enterprises and resells them to service businesses. Again, the IRS found that the activity did not preserve the natural environment -- it didn't say protect -- and it does not engage in any activities that generate environmental benefits. None of your activities actually cause a reduction in carbon emissions.

So, that's where I'm going to get to, and I think we're going to revisit this, because I think, you know again, you can't go more than three or four minutes without saying PRI, but when we do PRIs we see a lot of these things when foundations -- and I think Lois will talk a little about this -- what comes across for funders a lot of times are very different vehicles that might involve a lot of the things that the IRS said were not charitable in the rulings, which, granted, they took pains to say that this is all about private benefit, all about non-charitable class, but there are these statements in there that begin to set up this sort of dichotomy, between a direct environmental benefit and an indirect one. And where is that line is something that, I think, muddies the waters a bit for people who don't think that line really exists. So with that, I'm going to turn it over to Lois.

**DeBacker:** As I was listening to Tomer talk I was thinking about in particular those later rulings -- part of what I want to try to convey as I give my remarks today is that climate change is a game changer and it changes in part how we need to think about direct versus indirect and in something as big a threat as this, sometimes indirect contributions are really important, so we need to think differently about the frame.

As we were preparing for this panel, we talked a bit about how society's understanding of conservation and environmental challenges have evolved over time and how, in a similar vein, the IRS's interpretation of what constitutes environmental or charitable activity has evolved.

What we want to suggest, and persuade you of by the end of the day, is that, given what we now understand about the threat that climate change poses to global society, it is time for the IRS to consider energy efficiency and other activities that are crucial to combating climate change as charitable. As many of you know, the conservation movement in this country was inspired in large part by excessive resource extraction that resulted in the extinction of species and the devastation of landscapes. Early activists such as John Muir and Theodore Roosevelt called for the conservation of land and ecosystems that were really treasured by the public.

Those early conservation efforts were then followed by a growing awareness of the public health and ecological consequences of air and water pollution, resulting in the passage of new statutes like the Clean Air Act and the Clean Water Act. And more recently, we've come to understand the cumulative impact of pollution on larger systems, even global systems like the oceans and the climate. Many, many people now -- domestically, internationally and across sectors -- recognize that climate change is the defining challenge of this generation. We know that historic greenhouse gas emissions combined with those emissions continuing to enter the atmosphere through the burning of fossil fuels fundamentally threaten the quality and vitality of life on earth.

We're already beginning to see the effects of climate change, it has already begun to effect the frequency and intensity of storms, heatwaves, droughts and wildfires, the temperature acidity and productivity of lakes and oceans, the severity of air pollution, the geographic range of infectious diseases, the productivity of agricultural land, sea level and associated flooding, and the physical integrity of the built-in infrastructure. It will introduce increasingly significant social, economic and environmental disruptions and costs in the years ahead. And that organizations that recognize and speak out now about the threats that climate change poses to the environment, the economy, human health and human development worldwide are varied and extend well beyond the environmental community.

In its 2012 report "Turn Down the Heat," the World Bank cautioned that scientists predict that, absent some serious course correction, the world will warm by 4 degrees Celsius or more by the end of this century. That is 2 degrees beyond what scientists say must not be exceeded if we're to avoid catastrophic consequences of climate change. The World Bank described the 4 degree scenarios as devastating.

Climate experts tell us that time is of the essence if we're to have a hope of keeping climate change to a manageable level. In fact, the National Academy of Sciences has concluded that we need to reduce carbon emissions by 80% by the end of this century to leave open a reasonable chance of stabilizing the climate. A collective challenge is to decouple economic growth from the use of fossil fuels which, I think, is no small task.

So, if we care about climate change, policy change and the engagement of commercial and capital markets are the only forces large enough to bring about the de-carbonization of the economy that's required. Both policy change and capital at much greater scale must be deployed toward accelerating the use of renewable energy technologies, reducing energy use in buildings and industrial applications, improving the fuel efficiency of vehicles, and expanding mass transit and other alternatives to the use of cars.

Energy efficiency is a particularly important intervention point. According to analyses conducted by McKinsey & Company, energy efficiency represents the fastest, least expensive strategy for reducing greenhouse gas emissions. In 2008, they came up with a carbon dioxide abatement cost curve analysis, which revealed that implementation of energy efficiency measures can be accomplished at a negative net cost to the economy.

Given that other abatement measures are significantly more expensive, pursuit of aggressive energy efficiency is critical to achieving the necessary greenhouse gas emission reductions at a net cost to the economy that is as low as possible. But studies have also documented that there are tremendous barriers to moving forward with energy efficiency at the level we need to do. Those barriers they say are widespread and persistent and will require an integrated set of solutions to overcome them, including information and education, incentives and financing, codes and standards, and deployment of resources well beyond current levels.

Those of us in philanthropy think that there's an important role philanthropy can play in seeing that climate protection and the potential of energy efficiency is achieved. As society's understanding of the gravity of climate change has grown, philanthropic attention to the topic has increased. Foundations are increasingly looking to deploy all of the

tools available to them in the fight against climate change. Those tools include their thought leadership and convening authority, use of their grant-making budgets, program-related investments, market rate investment and outright divestment of their endowments from fossil fuels. In fact, as of September of last year, 70 foundations have committed to divest from fossil fuels.

Foundation leaders such as Rip Rapson, President of the Kresge Foundation, Larry Kramer, President of the Hewlett Foundation, and Carol Larson, President of the Packard Foundation, are using their bully pulpit to call for action on climate change. Other foundations such as the Barr Foundation and the San Diego Foundation are playing significant leadership and convening roles within their communities around climate change. Amos Hofstetter, the co-founder of the Barr Foundation, has provided tremendous personal leadership in the formation and work of Boston's Green Ribbon Commission, which has brought together senior executives from major employers in the region to define and execute climate change mitigation and adaptation strategies for their communities. Of course, grant making is a primary tool toward combating climate change. A growing number of foundations are involved in environmental philanthropy and according to data compiled by the Environmental Grant Makers Association, an increasing share of that philanthropy is being directed toward energy, climate and transportation.

Foundations have targeted much of their grant making at the policy change that is so urgently required. With respect to energy efficiency, grants have supported an array of strategies, including development of model energy efficiency policies, codes and standards at the federal, state and local levels, education and outreach to stimulate voluntary energy efficiency efforts, research into the energy efficiency gains that can be achieved through behavioral measures, and exploration of innovative finance mechanisms. Foundations are supplementing their leadership convening and grant making on climate change with program-related investments and market-rate investments. Staff of the Mission Investors Exchange shared with me recently that more than 40 foundations have expressed interest in climate-friendly impact investing.

While many of these foundations are at relatively early stages of doing so, others have a track record of program-related investment and market-rate investments. Those with a track record include the Kresge Foundation, the MacArthur Foundation, the McKnight Foundation and others. The growing interest on the part of mission investors is critically important. While the private capital market is moving in the direction of greater support for clean energy and energy efficiency, barriers to their engagement remain and private capital is entering too slowly. Philanthropy can be an accelerant. As Kresge's President often says: "Philanthropy can invest in ways that create on ramps for private markets."

Achieving society's climate protection goals requires that the market for energy efficiency grow deep and wide. We need to achieve deep reductions in energy use in the country's building stock, and achieving such reductions will require larger amounts of up-front investment and longer repayment time. We also need to reach markets that are not currently served by private sector energy service companies. Those include smaller buildings that are difficult to reach and aggregate. And we must prove to capital markets that the perceived performance risk and credit risks associated with energy efficiency loans is less than currently thought.

What I would like to do is share one example, and it think it will be a segue into going back to Tomer and Dave. An example of philanthropy's role in a very promising project that's been supported by the Kresge and MacArthur Foundations, along with the High Meadows Fund, the John Merck Fund and the Vermont Community Foundation. In 2012, four of those foundations provided grants to the Vermont Energy Investment Corporation, a 501(c)(3) organization, to allow it to develop a business plan for a public purpose energy services company.

As conceived by VEIC, the public purpose energy services company would target the currently underserved market

represented by small to mid-size public serving buildings such as health clinics, schools and multi-family housing. The nonprofit model would allow a lower return on investment, and the pursuit of all cost effective efficiency measures, including those with longer payback periods, thereby achieving the type of deep reductions in energy use required for climate protection.

The organization successfully completed its business plan, and the foundation subsequently invested in the launch of the public purpose energy services company called Commons Energy. Through a combination of grant funds, program-related investments and loan guarantees, the PRIs provide capital that allows Commons Energy to provide subordinate financing to its customers for the energy efficiency measures implemented in their buildings. Kresge's loan guaranty is designed to stimulate a minimum of \$20 million in additional non-philanthropic capital.

Our expectation is that Commons Energy will demonstrate over the next several years a self-sustaining business model that makes it possible to achieve much needed greenhouse gas reductions through energy efficiency in otherwise unserved markets. The energy efficiency and loan performance metrics tracked by Commons Energy will provide assurance to the capital markets concerning the perceived risk of investment in energy efficiency. In addition, the organization has shared its business plan documentation publically. We hope that will allow the business model to be replicated by others in geographies not served by VEIC.

The investing foundations all view Commons Energy as an important model with strong climate protection implications, yet our PRIs could not be deemed charitable based on the public good that is energy efficiency. As one of the investors said: "Given the urgent need to reduce greenhouse gas emissions, we should not have to limit our social investments in energy efficiency to only projects that directly benefit low-income communities." The fact that the IRS does not consider energy efficiency in itself a charitable purpose causes considerable friction in the process and, most likely, deters program-related investing in energy efficiency. No offense, but the expense of legal counsel and the complexity of the rationale that currently must be put forth may discourage mission-oriented investors from directing their funds to activities such as energy efficiency that are beneficial to climate protection.

I'd like to close with a quote from an opinion piece that Larry Kramer of the Hewlett Foundation and Carol Larson of the Packard Foundation recently published in the *Chronicle of Philanthropy*. It's really a call to action to other foundations to get engaged in climate change. What they wrote was: "When we consider all of our grant-making priorities -- children, education, health, reproductive rights, oceans, our communities and so much more -- it is profoundly clear that climate change has the unique potential to undermine everything we care about as foundations. All the charitable purposes that foundations support are put at risk by climate change. Given the nature of the threat, we believe that philanthropic investments to reduce the severity of climate change should be considered charitable, particularly investments in energy efficiency."

**Inbar:** What's interesting for me listening to that, right, that all sounds fabulous. And then, I turn it around into an exemption application. Or I turn it around into a PRI opinion. And I say, so what is Commons Energy doing? Well, ultimately they're helping small, medium-sized organizations to get capital to make changes to whatever their infrastructure is that will enable them to save money. And I'm doing this on purpose, that will enable them to save money on their energy bills.

I'm giving a benefit to a non-charitable class namely. In this case, they happen to be hospitals, or they happen to be nonprofits, but we all know that just serving a nonprofit doesn't necessarily mean that we've done something charitable. Then, looking at it through the lens of some of the rulings that we talked about right before Lois started, and asking, so is there too much private benefit here suddenly? Where's the direct charitable impact? I think about it, well, of course if we identify these things as necessary to fix, because without fixing them we still have this huge

problem, then that should be and it seems to me to be charitable on a certain level.

But then we flip it to the other side and say, well, we've just given a business or a landlord or someone very cheap capital, we've allowed them to make upgrades to their facilities, they're saving a lot of money, is that too much private benefit? And that, I think, is part of the conundrum some of us face when we are looking at some of these things through, on the one hand, there's great program reasons to do it and, on the other hand, asking who's benefiting and why, and whether that should even matter.

**Shevlin:** It seems as if some of the language from the 2012 rulings that you were citing to are creating some stress for us because when you have private benefit that you can sort of ring fence and say this is -- like your example of there was private benefit coming out of the curtains and the walls -- what it's about, overcompensation and those kinds of issues that are distinct from the core of the activity itself, it makes it easier for you. But it started to become a concern that the private benefit issues were chipping away at what had been evolving as some comfort around environment standing alone and not dependent upon the other hook in the earlier rulings. So that, that's the concern.

Think about Lois's really powerful remarks and how do we reconcile what is clearly, I think, like I said, a very compelling perspective on the role of philanthropy and the environment because of many other factors that are limiting private sector entry, etc., with where we are from a regulatory perspective. Tomer had asked me to give an example from my actual experience, which happened with this carbon offset revocation where we were actually evaluating a program-related investment in an entity that was doing a carbon trading market, if you will, at the very time that the revocation came out.

And, in a sense, interestingly, all of the messy private benefit stuff, it almost helped on the PRI analysis. Because you were able to say, look, it's not a questioning of the core of the charitability of this, it's just that this entity just did not have their game straight. But when you start to see the additional language that seems as if it was kind of going hand in hand with the private benefit language around the lack of direct ecological benefit or, in other type of language, it made you pause.

Now, it so happened that in that case, I did get comfortable with the PRI in that particular example because it satisfied the three factors, and we won't go through them, but there was a clear charitability element that my client had manifested. And so, I do think that it is completely conceivable to continue to have PRI investing in organizations that may not always be able to measure up for exemption themselves. What do you think about that?

**Inbar:** I think that's probably right, but I think that Lois's point of the chilling effect, that, notwithstanding your very expensive counsel [laughter], notwithstanding the fact that organizations with good counsel that know this stuff can get them to the right place, those aren't really the targets here.

What happens is, I think, there's a very chilling effect below that 1% or whatever percentage of the large foundations or the sophisticated organizations doing impact or program-related investing where below that -- and this is something I hear often -- we can't do that because. And so, it's not chilling the people who are at the top doing this stuff, because they have good advisors, they have great program staff, it's chilling people who would like to do it. They feel like they can't because either they're being told they can't by their lawyers or accountants or they're doing some research on their own and seeing some of this tension, and they don't want to go there and they don't get enough comfort that they can do it.

It's something we struggle with as more and more of our conversations turn to market-based solutions and commerciality and investing and etc., etc., etc. -- the private benefit thing looms large, right? This is something that

we all struggle with, but to Lois's point in the beginning, how do we think about it differently when what we're trying to accomplish might be different and using different mechanisms and do we have the right tools and are we in conjunction with the IRS thinking about this in the right way? Or should be not go there?

Another important point is whether or not you agree with anything Lois said, right, whether or not you agree with a particular issue, within our sector, we're allowed to have issues that we believe are important and follow them, and as long as they're charitable, it doesn't matter if you don't buy it, necessarily.

**Shevlin:** That's right.

**Inbar:** And so, that's what is so fascinating about this, is that it's almost like there's -- you listen to this notion of credible scientific evidence about solar systems -- do you buy it? I just want to say that as much as possible. That might be charitable.

**Shevlin:** One of the things in trying, again to divine where we're heading on this, from a regulatory perspective, Tomer suggested looking at what the ABA has submitted in terms of environmental examples for PRIs way back when and then looking at the 2012 actual proposed regulations with the new examples in PRIs and how those matched in terms of what we submitted, in terms of environmental examples, and what came out and there's some variations.

In 2002 and 2010, the ABA's new PRI examples including several environmental scenarios, including a start-up for-profit developing a new organic farming process, foreign for-profit investing in environmentally-oriented businesses in developing countries, and a solar development fund to bring power to unelectrified regions of the world. These were very, very thoroughly thought through and considered by the ABA in terms of submitting these examples.

In 2012, the proposed regs did include environmental examples that were informed by the ABA to some degree and, importantly, the preamble noted environmental deterioration as a charitable purpose that could be accomplished by a PRI and that's helpful to remember. There was an example that involved an entity that was working in a developing country to collect recyclable solid waste. But several of the other examples that were submitted were not picked up.

When the ABA commented on those proposed regs, what we said was, look, it's our understanding that the environmental examples that we submitted were not included, not necessarily because you think that they're problematic under 170(c)(3) and from a 501(c)(3) perspective, but that they raise sort of other problematic issues for you, which came up in non-environmental examples with the PRIs.

But that ties right back to this issue that we're talking about where other aspects of these scenarios are troubling, but we don't want to see that sort of chipping away of what was sort of a positive evolution in the thought process that environmental protection, if you will, whether manifested through energy efficiency, climate change opposition or otherwise, has in and of itself a free-standing charity component to it.

Before we go to questions, it's interesting, as Tomer said, with whether you buy this or not, for those of us who have clients working on environmental issues outside of the United States, there are significant challenges to doing so. Our friends in the room from Canada will tell us about the number of increasing audits that organizations in Canada that are engaging in environmental activities are undergoing for purported political activities. In India organizations that have environmental preservation as one of their main objectives are finding themselves without the necessary licenses and permissions of the native government to pursue their objectives.

So the political overtones to it are having an impact on philanthropy's ability to comment, to participate, especially

outside our borders. But maybe this is really just the first step in terms of getting to the points that Tomer was talking about, about trying to sort of help from our perspective in the field and the regulatory perspective as to how to arrive at a comfortable place that will move us forward and recognize the charitability of this activity, but also understanding the needs while obviously not dismissing the various serious issues around private benefit that have to get grappled with as well.

**Inbar:** Right, and going back to something, I guess, where Lois was, and that may be a question for you, when you're thinking about these types of activities, so when you're thinking about an energy efficiency program that provides for energy efficiency audits or upgrades to appliances or things that might not only be targeted at low-income people, but that have significantly broad practice -- when you're thinking about this, how do you think about those from an impact standpoint? And where does that come in?

**DeBacker:** Well, I guess I'd say that the starting point is that there's a real urgency of having more energy efficiency in place. There are a lot of market barriers. Some of those are informational, some of those are just there's wrong policy incentives and some of them are financial. And that there's a need for some test cases that it is possible to serve those markets so the philanthropic dollars can -- as I think is the case with Commons Energy -- play this role of proving out that something is viable, making the way for private capital to come and step in and serve that need. So, again, and yes, there may be some individual companies or homeowners that benefit from it, but the larger public good is so strong in this that I think it's proving the viability of the model that can then go serve others without philanthropic investment.

**Inbar:** What's interesting about the way Lois, as the non-lawyer in the room, said that, is that when we think about the private benefit being incidental or insignificant, that in almost every program that we look at as lawyers, as in-house people are looking at, as program people are looking at, the judgment is, is the private benefit incidental or what is the primary benefit here?

That's a determination we make in every aspect of the philanthropic community in grant making and programming, etc., etc., and that's a judgment call. That's something that, if done right, and if done with integrity, organizations should be allowed to have flexibility in doing that, because of what they recognize as the primary charitable objectives.

**Shevlin:** So with that, what comments and commentaries and questions do we have from all of you?

**Fei:** Rosemary Fei, San Francisco. I think what I hear you saying, which I have used in my analysis of PRIs from time to time, is that timing could be a very important factor. If you're going to have these, maybe it's a technology that will be good for the climate, it's got to be pretty widely adopted, and maybe ultimately it's got to be put out there by an Apple or a Microsoft or an Amazon, or somebody who's really going to get it to everybody. But they're not going to do it at the beginning because it's experimental, it's risky and so on.

I've often found that if you think of it as -- I'd be curious if you agree -- that there might be certain PRIs that could be made at one point in time and could not be made at a later point in time. And you can anticipate that if it's going well you're not going to be able to make it. Of course, that raises the issue of whether you have to pull out of it. I think you actually don't under the current regs but you might not be able to make it new later in time.

My other comment is that I think I hear a thread that I've also used in PRI analysis involving being able to show the charitable purpose and also the necessity of the private benefit -- because it's a weighing task -- is the private benefit incidental and tenuous or is it too much? If you're looking at whether there's been market failure, and I'd be curious

as to whether you think it would be helpful, for example, in PRIs we have presented as part of our opinion the fact that the entity has tried to get financing in various different ways and has completely failed. And that sort of relates to my timing point as well. So I'm just curious about your comments.

**Inbar:** I think that's probably right -- sometimes I have a conversation with my client where they want to go in when it's really too late, or they waited too long. And the question I ask them -- and I know I shouldn't do this, so I apologize to anyone who's offended by this from a lawyer -- but I say: "Is your money really needed here?" At a point in time your money is really needed to do the things that Rosemary is talking about.

I think that dovetails with the notion of what it is that you're trying to accomplish with the charity piece. At some point, it might not be needed anymore. From my PRI perspective, I sometimes ask -- I'm not sure that I come out that way all the time, because sometimes my clients have convinced me and said, this is why we're doing it now, and their reasons to do it. But the first blush is, is your money necessary to go in now? It's not the same reason it went in in the beginning. It could be a very different reason later on because there are tons of other reasons why a charity might go in to the Google or the Amazon or whatever it is after it's being more widely adopted.

**Shevlin:** Those are questions that we ask ourselves outside the environmental PRI context and other PRI contexts as well, so that's a very cogent point. I agree on market failure, that that's a relevant facet to consider.

**Bjorklund:** Victoria Bjorklund, New York. I have a question as we are now seeing climate change deniers taking active roles in trying to seek to defund, let's say the climate change bureau at NASA, and I expect that's just the beginning, maybe NOAA will be next on the list. If they are successful, do we see a role for philanthropy in coming in and how would that role work? This should be potentially, unless the agencies are dissolved, grants to government as they wouldn't need PRIs, they wouldn't necessarily need to be charitable, but have people been thinking about that in the role of philanthropy in that contingency?

**DeBacker:** There's always great concern about philanthropic money funding things the government should be funding, so I think as I've now been part of conversations around that, our hope is that those who have an economic interest in pretending that climate change isn't real will be discredited fast enough. I mean, the opinion polls are showing more and more that the majority of Americans, including the majority of Republicans, believe that climate change is real, they understand it's real, and so my hope is that the deniers will be marginalized.

**Colvin:** Greg Colvin, San Francisco. As you were mentioning energy efficiency, it clicked in my mind that Rob Wexler and I -- gosh, I think it was 20 years ago -- went through an IRS audit with an organization for (c)(3) that had those two words in its name. I just looked on my computer to see how we got through that, and it's because their focus was educating the public and changing public policy toward energy efficiency and renewables and so on, so that perhaps if you had difficulty focusing on the technology and the economic business of various technological answers, if the focus is on affecting public policy, perhaps it's an easier case to make.

**Shevlin:** Thank you for those comments, and it gets back to, what are the other hooks besides environment or energy efficiency?

**Inbar:** That does raise the question of, should we do that? And I think that gets to the point that are we doing -- and I'm not advocating one way or another on this -- but are we doing ourselves a disservice by putting something that should be charitable in its own right for a specific reason into another charity box? And are we as effective? And if the answer is maybe, that's fine.

But that's a conversation I think we should have as opposed to -- because I think we do this all the time, right? We were looking at a PRI that was going to make loans or guarantees for a restaurant and service industry establishment to upgrade their systems and, evidentially, there's a lot of waste in that sector and it would have saved a lot of energy, except that when we looked at it we ran into the same problem so we said, well, focus on low-income communities. There were other reasons why it didn't happen ultimately, but the knee jerk reaction was to push it to the easier place to do it, and that might not have been the best place for us to do it.

So I think to Lois' point and to the points that we've been hearing, at the heart of it is a question of where is the right box for this to be? Should it be on its own or should we have to have low-income people? Should we have to have education? Should we have to have demonstration, like government, etc., etc.?

**Shevlin:** And it looked like we were moving away from that need and we won.

**Wexler:** Rob Wexler, San Francisco. I always try to keep in mind the difference between the standard for charitability for program-related investments and for direct activity, right? I think we can make a lot of headway with program-related investments by furthering a charitable purpose of the foundation even though the underlying activity maybe in a for-profit is not something that would qualify for exemption. Right? You're with me on that?

**Shevlin:** So far, so good.

**Wexler:** Okay, what I'm interested in is whether Lois thinks, as a non-lawyer, do you think we're at the point where -- we have nonprofits that are basically running businesses like hospitals and schools, and we say that that can qualify for exemption because of the underlying purpose. Do you think that a nonprofit that is selling solar panels at fair market value and that is doing things directly to remediate carbon problems, greenhouse gases, for a fee, should that organization -- I'm not saying it shouldn't, I'm just curious as to your answer -- could that qualify for exemption, or should it?

**DeBacker:** I'm not sure. I haven't thought about that exact example a lot and, as I was reading the Columbia paper and the outline that Leila put together, I thought, there are some things where it shouldn't, you know? So I think, I think it's important to think really carefully about where you draw that line.

**Shevlin:** One last question if it's a quick one.

**Spitzer:** Lorry Spitzer from Boston. Three quick comments. This was an excellent panel. Thank you so much.

**Shevlin:** Oh, in that case, we have plenty of time for your compliments [Laughter].

**Spitzer:** And just a request, that we do more panels in the environmental area. A couple of ideas would be to have a panel thinking about a revenue neutral carbon tax, we could take that on as well as anyone. And also the question about charitable organizations that shift their charitable purposes towards the issue of climate change, because without that issue being addressed, their interest in landscape or animals or what not becomes moot. So, thank you very much.

**Shevlin:** Thank you. And please join me in thanking Tomer and Lois so much for their great comments here [Applause].