

>> Susan DeSanti: Her research focuses on methods and tools to reduce the cost and difficulty of investigative and accountability journalism. And she actually noted something about what she's looking for because she was a reporter and editor at "The Washington Post" for more than 10 years, and she shared in the 2002 Pulitzer Prize for investigative reporting. Sarah?

>> Sarah Cohen: Thank you so much for having me here. The first thing is that this is my first foray into a forum like this. As a reporter, I don't think we would have ever done this. So, it's a new role for me. And I really appreciate the commission's interest in accountability and investigative reporting and what I would call, broadly, public affairs reporting. I know that you all have been talking a lot about business models and revenues. And as Susan said, I am working more specifically on the cost of reporting and particularly the cost of discovering new stories, rather than the cost of producing them or putting them online or distributing them. And as I started looking into this, I'm looking at both technologies and ways that tools can be used, that are being used in other fields, like in homeland-security research and things like that. But I also came to the conclusion that the single biggest thing that the federal government could do, in order to reduce the cost of reporting, is to simply improve the public-records Implementation, What I mean by the Freedom of Information Act implementation. There are -- In my 15 years of an investigative reporter, that process of extracting records from federal, state, and local governments is by far the single most costly and difficult portion of accountability reporting. If you can't get the records at all, you can't do the stories, usually. And if you have to sue, it will take years and tens of thousands of dollars before you're done. So, rather than kind of complain about this system, which we tend to do when we get a lot of reporters together -- all we do is complain to one another about them -- I wanted to suggest some specific steps that could be taken to reduce the cost and difficulty of that side of the reporting equation. I'm not saying that there hasn't been any progress over the last year. I think a lot of people were very optimistic when the new administration arrived with a transparency agenda. But it's been slow, and institutionalized secrecy is something that is going to take a very long time to change. One of the first things is to -- One of the first suggestions that I had was to institutionalize the release of very common

accountability records. And what I mean by that is the records that are used to monitor agency activity. These are almost never available without a Freedom of Information Act request, and they often take months before they are released. Things in this category include things like audits of grants, calendars of cabinet- and subcabinet-level officials, correspondence logs, FOIA logs themselves, and personnel records of political appointees. These are pretty basic records that, every time they've been litigated, they've been shown to be public, and they're very difficult to get. 1996 E-FOIA law required that agencies post on their website something called their major information system reviews. And this was geared at the idea that, before you can ask for a record, you have to kind of know what's being kept and how. And very few agencies have updated these record-- these major information systems descriptions in a long time. And when they have, it's a very unfortunate thing. It's just a small little omission that makes it incredibly hard to use. There's no date on it. So you have no idea whether these are 10-year-old information systems or whether they're current. And there's no contact name, so you don't know who to call to ask. It's a very small thing, but it can send you right down the wrong road very quickly. One of the biggest things that I've seen work -- in, especially, the state of Florida 15 years or so ago -- is to require building openness and transparency into every new information collection and every new retooling of a system. I don't know whether it was a law or a policy or a practice that changed in Florida, but about 15 years ago, they started doing this, and they did things like in a contract clearly distinguishing what was commercially secret and what was available to the public. And in a database, they made a huge effort to avoid the use of proprietary or private unique identifiers, like a Social Security number or D-U-N-S Number. And for every new system, they built in, "How are you going to extract this for the public when you need to?" even if wasn't intended as a public system. Some of the systems in government that are incredibly hard to extract information from for the public are very simple. They're things like e-mail systems that are almost impossible to search in most agencies for public records. And contracts and grants routinely commingle proprietary information. And databases throughout the federal government are using something called a D-U-N-S Number in order to identify organizations, which is a proprietary code that can't be shared with the public in full. Other things that were done there that helped were things like splitting

fields so that the public portion could be extracted. A simple example of that would be to distinguish the five-digit zip code from an address field or to split out a date of birth into the year, month, and day so that you don't have to get somebody's date of birth in order to get something about the age -- things like that. And the last way that this could be institutionalized is to work it into OMB's review of information collections. I believe every three years, every information collection has to go through a review of OMB. And I believe that there's a fairly extensive list of requirements to make sure that it's secure, make sure the private parts are private, make sure the national-security parts are secure. And those are great priorities, but I don't believe that there is a similar requirement that the open parts be open. And that may be one way to institutionalize these issues so that, in the next administration, it won't take a sympathetic administration in order to keep open records open. Another series of things that could help on these issues is to remind those who do business with the government that their information is subject to Freedom of Information Act requests. We're now running into a series of issues where requests for records are sent back to the original person or the original company for their permission to release the records. That's really new, and it's not something that was ever anticipated, I don't think, in the law. There's another piece of this that's a recognition THAT, FOR most reporting, it's state and local records that are the most important, not necessarily federal records. And I know when I was working on some stories at the local level -- for instance, child deaths in Washington, D.C. -- the way that we got records on those deaths because a federal grant that the District had taken required that District made certain certain information available about the results of what had been funded with federal money, and making sure that some of these grants that are given out also include requirements for state and local governments to make -- to also include the transparency. And that's especially true since state laws differ so much on public records. And the last thing is to have a clear path to resolve issues. There is now -- I believe people are calling it the ombudsman's office in the National Archives -- the Office of Government Information Services, I believe -- and that may show some promise in having a way to resolve disputes without going to court. And that would be a useful way to be able to do it. There's another set of things that -- that could help preserve some of the accountability reporting, and this is the more technological side of the equation. In general, academia

has not done much in journalism to really move it forward. It has not been a leader, traditionally, in the field of journalism. It's been a follower. And most change in technological advances have come from the news room up, and then out into academe. That's changing very rapidly. There is no investment going on inside news rooms anymore. And I think the academy is beginning to step up and try to look at research that can be done. In that vein, some of the things that the federal government funds in other realms might be useful for journalists, but are not always easy to get ahold of. And what I mean by that is software that is developed under federal grants are often awarded copyrights, and I understand the need to attract developers to create software for the government or software for research, but there may be some way to build an encouragement to either give it away for free or to open-source it for public activities and to include journalism under the rubric of a public good, in that sense. The same thing is true for federal facilities, federally funded facilities. I know there's a resea-- There's a basically supercomputing center in North Carolina that's largely state-funded -- not federally funded -- that is not allowed to let any commercial activity go on in their -- on their premises that are using their facilities. And what that does is it precludes things like the ability to use some facilities for things like optical character recognition of large document collections, which might take my little laptop and most of the computers that are inside a news room 4 or 5 days to recognize a 10,000-page document, but a much more sophisticated computer setup might help with that kind of thing. And the last thing that I wanted to mention -- and this may seem a little self-serving, given my current job, but -- is to also consider whether or not journalism, as a public good -- It might be worthwhile to start funding research into it the same way that research is funded into history or social sciences or other activities inside the academy. But I understand that idea, that it's -- it's a hard thing to envision, what kind of research we might do, but right now what we are trying to do is to latch on to some of the research that's been done elsewhere. As an example, one piece of software was recently done using federal funds - - that is, a way for federal agencies to look at comments and regulatory activities. And it's a very sophisticated text-mining operation, but it's not available for reporters to look at things like similar documents in state and local government. And it's owned by two Universities, and it's copyrighted, so it's not available for general use. And so that kind of

research into how to deal with large collections of texts, how to take notes, how to do a whole lot of things that journalists do every day, has never been undertaken, and it might be time for that kind of research to start. And that's what I have. Thank you. [ Applause ]

>> Susan DeSanti: Thank you very much, Sarah. We really appreciate your willingness to join us for your first foray. And I think the kinds of ideas that you're coming up with -- very practical, nitty-gritty ideas -- hold some definite promise. Now we're going to hear from Rob Atkinson who is founder and president of The Information Technology and Innovation Foundation, a Washington, D.C.-based technology policy think tank. He has an extensive background in technology policy, has advised state and national policymakers, and is a well-known speaker on innovation policy, nationally and internationally. Rob?

>> Rob Atkinson: I was told this can go up. Thank you, Susan. It's nice to be here. So, I want to also talk about this question, although I probably will spill over slightly into this other question of how technology can also lead to revenue increases. I want to start by framing this a little bit, in the sense of -- Part of the reason why we're having this conversation is we're talking about a set of industries in the economy -- and, in particular, journalism here -- that's been transformed by ICT. And economists -- a lot of economists call ICT what's called a general-purpose technology -- in other words, a technology that can be used across many different industries for many different functions. And when you look what's happened in the last decade, we see industry transformations that are going on in virtually every industry around a whole set of similar processes that we're seeing in media -- clearly atoms to bits -- in other words, moving to web delivery, a whole set of financial institutions now, for example, like ING bank or E\*trade, that don't do any sort of paper delivery anymore. There's no physical bricks and mortar. It's all web delivery. Intense competition -- one of the defining aspects, to me, of the Internet economy is it allows companies to get into other people's business. And so what used to be relatively defined market segments are now much more -- the boundaries between them are much more amorphous, and we certainly see that, obviously in newspapers with the classified

ads and other types of the business being competed away. Third is consolidation. When the Internet first emerged, a lot of people thought it would have the opposite effect. In fact, it's having the effect of enabling consolidation because you can run things centrally. You don't need as many disaggregated pieces of that. And I think we will see that -- we are seeing that and will see that in newspapers. And lastly, obviously, disaggregation, the whole notion of being able to bundle things together and take various pieces out. If you think about sort of industries that are transformed, one of the key things the Internet does is it lowers costs. And for most industries, that's a great thing. It's like, "Wow, I'm going to lower my cost structure 25%. Why isn't that positive?" And in a lot of industries, we see it's very positive. We see it in travel. We see it in banking. We see it in retail. We see it in logistics. Where the cost structure is down, output is up. I think the two industries that are closest to news in this regard are -- one is the Postal Service. Mail, if you will -- I'm gonna call it -- In other words, things going between places are up, you know, 1,000%. It's just that the post office isn't getting any of that business because it's going to Google or other types of E-mail or things like that. So, in that sense, it's good for the process. It's bad for the firm. And the other, to me, is music, the ability to -- or new movies -- the ability to get digital content. Again, that should drive the growth of that industry because the cost structure now of the music industry is much better than it was a decade ago. You can lower your production and distribution costs by anywhere between 30% to 40%. People ought to be buying more movies and more music. They're not, obviously because of piracy. So, obviously there are some industries that are able to take digital transformation and the cost advantages and grow with it. I think the key question is, "What's gonna happen with journalism?" The Pew Project for Excellence in Journalism stated last year, "Yet it is all now but settled that advertising revenue, the model that financed journalism for the last century, will be adequate to do so in this one." I'm not sure that's true, and let me explain why. I think it's not true for two reasons. One is digital technology can lower costs and also increase revenues. Let's just talk about lowering costs for a minute. The reason why it's so hard, I think, for newspapers is that what they're competing with right now is not really -- not really newspapers. They're trying to get people to go to this other device, this thing, which really looks and acts nothing like a newspaper. It's an expensive device, and I only have one or maybe two of

them in the home. They're not ubiquitous. If this were a newspaper, I can carry it with me and I can read it at my -- my morning breakfast table. But what's the real value of a newspaper? It's clearly -- It's not the pulp from the ground-up trees that's delivered to my house every morning. I don't pay "The Washington Post" and "The New York Times" money for having them deliver paper to my house. I pay them money to deliver information to my house. So, in theory, one could imagine, essentially, display technologies that replicate newspapers. So, in a way, you could suggest maybe what we'll end up really needing is not newspapers, but news E-papers. And if that were the case, then you could envision a -- you could envision a world where we don't have newspapers -- we have news E-papers. And if you do that, the cost reduction could be significant. There are various cost estimates that are thrown around. One -- a little bit dated -- I found for news-printed ink are 14% of costs, more than news and editorial production. Circulation costs are 11%, production costs 8%. So, this suggests that E-delivery could cut 30% or more percentage out of the cost structure. There's a study by Thurman and Myllylahti out of Finland that found that when the Finnish financial daily "Taloussanommat" cut delivery, over 50% of its costs were reduced by moving to a digital format. Unfortunately, 70% of its revenue was also reduced because they couldn't get the same advertising. But the reason they don't get the same advertising is because people spend a 10th of the time online for the news than they do with a piece of paper. So, I think part of what we need to be thinking about is -- How do we get display technologies that let people spend 25 minutes a day on a news E-paper? And I think the entire business begins to change there. You know, I remember four or five years ago people saying to me, when I was advocating that E-books would be a big thing in the future and ultimately would eliminate paper books -- people would say, "Oh, come on. That's not going to happen." Four or five years ago, and people said that. Look at where we are today. We'll have probably around 7 million E-book readers sold this year -- obviously, the Kindle, but the other readers, the iPad, the Apple's iPad coming out in a few weeks. These, to me, would be what I would call stage-one readers. They're certainly more convenient than having to carry around a laptop or desktop. They certainly could, in some ways, substitute for the paper portion. But I think the real sort of promise is in the next generation of these technologies -- flexible display technologies, essentially things

that look like this and feel like this that are -- have the feel of paper, but are essentially just bit-display devices. These technologies are -- at least, according to some engineers I talk to -- you know, a couple years away from marketplace emergence. And even pretty interesting technologies -- Arizona State University -- they have a Flexible Display Center. They're working with HP and some other companies. They've developed a touch-screen active matrix technology, like this. It's like this, only you touch it, and it responds, just like you would on touching a screen on your iPod, let's say. So, those technologies, to me, suggest that at some point in time, it'll get a lot more like reading a paper. And as a result of that, people will be spending more time. And as a result, ad rates could go up. You could envision getting rid of paper production completely and still getting the paper experience. Another technology people don't talk about is surface computing. Microsoft has developed this. A couple other companies are working on it. Service computing is essentially a table that is a computer service. You touch it. Things come up. You could envision a surface dining-room table, where my wife is over on her side reading the Style section and I'm reading the Sports section over here and my son over here is reading the Business section, all on the same dining-room or kitchen table. That technology is there today. It's a little pricey, but with more law, one would assume the price is going to come down. I think even more interesting are the whole notion of surface projection -- M.I.T. Media Lab is working on this -- where you can project right onto a wall. So, in other words, you don't have to -- You can project it onto almost whatever you want -- in other words, a picture of the newspaper, and just, you know, touch something. You can wave your hand, and the wall changes. So you don't even need an active display. You can just use passive displays like we have all around us. So, I think those technologies are going to come. The real, I think, question to me is, "Well, will newspaper survive long enough before the savior of new displays emerge?" It would be interesting if we actually flipped it around. If the Internet was going to emerge in 2020 and flexible displays emerged in 1995, we'd probably be talking about the golden age of media right now because their costs would have gone down 35% and their readership would have stayed sort of constant. Obviously, we're in the other way. By the way, one other nice piece of this, by the way -- according to a report that we did and looked at research on this -- reading your newspaper on a display like that is -- produces

less carbon by -- 32 to 140 times less carbon emissions into the atmosphere than getting your newspaper delivered to your home. So, as I said, one of the advantages, if people can start reading E-- assuming news E-papers, you can imagine advertising revenues increasing by a factor of five, even tenfold because the amount of time spent sitting there reading them -- it would go up 5- to 10- to even 15-fold. But I think the second piece of this -- economists talk about cost reduction, but it's in the context also of quality. So, they -- So, if quality goes up and the price stays the same, that's essentially a cost reduction to an economist. And I think we have to talk about the fact that there are technologies now that are going to allow what you call mass customization of the news. Now, obviously the Internet is doing that. You can get, you know, a site customized to you, with your interests in news. But what's, I think, interesting -- and I don't think a lot of people are aware -- is we're beginning to see that in paper. So, historically, if you wanted to have paper customization -- in other words, a magazine like magazine like "Newsweek" or "BusinessWeek" -- if they wanted to customize it, they'd have to essentially print it with a digital printer -- very slow, very expensive. And instead, they use offset printers, which are very fast, very cheap. The only problem with offset printers is they'll print off 200,000 copies of "BusinessWeek," and each copy will be exactly the same. What's interesting is that at least one company that I'm aware of -- Kodak -- has developed new digital-printing technologies that have more or less the speeds and quality and cost structure of offset, but with the customization of digital. Kodak calls their technology Stream Technology. The advantage of that technology, when you think about it -- It's not at the newspaper level, but it's certainly at the magazine. So, if we're talking about magazine journalism, this, to me, is a potential very important breakthrough in technology because it would allow "Newsweek" to produce 400 or 500 or, in theory, 100,000 different "Newsweeks" every week. I could tell "Newsweek" that I'm more interested in international and I'm particularly interested in military affairs, and I would get a few more stories on that, and I would get no stories about wine, which I get in my "BusinessWeek," which I find a total waste of time, why I'm reading about wine in "BusinessWeek." In other words, you can mass-customize "BusinessWeek," news week "Newsweek," "Time," these sorts of things. If you do that, obviously the value to the customer is greater. They're more likely to subscribe. They're possibly even more likely

to pay a little more. But you also get cost reduction. So, one of the problems with magazines right now is that you have to ship them somewhere, and you -- since you have economies of scale, you're weighing that against distribution cost that tends to be -- you print a lot in one place and ship long distances. This technology -- In theory, you could imagine that every major postal regional station, like the one out in Manassas -- every major metro area has a printing facility right located 100 yards from the post office. And "Newsweek" is printed, you know, in Columbus, Ohio, and it's printed in Cleveland and it's printed in Indianapolis and it's printed everywhere, as is "BusinessWeek," as are all these, then they're just mailed, if you will, that very short distance. And with mail rates being, you know, a significant component of that cost, you end up reducing cost of that. Let me just close by saying the other advantage of all of that is on the revenue side. Clearly, mass-customized newspapers could have mass-customized ads. So, I can tell "BusinessWeek" that I really like big-and-tall clothing and they could give me big-and-tall clothing ads and, as a result, they would get more money for those ads. So, I think this notion that if you get more customization there, you'll also get more revenues in addition to lower costs. Lastly, one of the policy implications of this -- I know this is FTC and not the National Science Foundation, but it strikes me that one, certainly, policy step that the federal government could take would be to do a lot more research-- do a lot more support of display technology R&D. We have a couple of centers around the country that do this. They're relatively underfunded. This is an important technology not just for the news business or news industry, but for a whole set of other applications throughout the economy. And better displays that are more clear, more flexible, et cetera, more portable, would help not just the news industry, but the overall economy. So, that would be one sort of simple thing the the NSF could fund there. I think the second thing -- Next Tuesday we'll be hearing -- Excuse me. Next Wednesday, we'll be hearing about the National Broadband strategy that the administration will be unveiling. Clearly, there, I think, is an important area. If more people are online, if more people are able to get their news online, that certainly is going to help on the revenue side, but also, ultimately, to allow newspapers to get rid of paper because one of the things that's holding that back, to some extent, is not everybody uses digital means. And lastly -- Again, I'm more on the revenue side. I think it is important to think that certainly some efforts on privacy might

go slightly in the opposite direction. We do want newspaper publishers to be able to maximize ad revenue, I would argue, and that means getting better information about users will help to that. So, let me just close by saying I did a little calculation looking at current revenues of the news industry -- the newspaper industry and where they are today. If web-ad revenues grew 22% every year -- which you might think is excessive, but I think it's actually probably reasonable, if you were to shift to these other types of technologies -- and costs were 70% of where they are today -- which I think is, again, pretty cautious -- in a decade, revenues would exceed costs. Revenues would exceed where they are today, and so, in a lot of ways, I think what we're talking about is a decade of uncertainty, but potentially technology could play an important role in a sustainable future. So, thank you. [ Applause ]

>> Susan DeSanti: Thank you very much, Rob. I'm always -- I continue to be surprised when I shouldn't be that every speaker comes up with new ideas that, in fact, we haven't heard before. So, thank you very much for your introduction of more new ideas. Okay, now we are venturing into the area of corporate law and tax law with a great deal of trepidation, but, nonetheless, this is an important area in which some proposals have emerged. So, we need to understand it. The basic idea underlying this discussion will be how to create a hybrid, nonprofit/for-profit entity that serves a charitable purpose and can operate consistent with all the relevant laws, such as tax and corporate laws, and then, most particularly, can be tax exempt. In our case, we're looking at journalism as possibly fulfilling a charitable purpose. But this movement toward social-purpose entrepreneurship -- that is, finding a way to combine non-profit funding with funding from commercial investors to achieve a specific charitable purpose. That movement is far broader than -- and has many more applications than simply in journalism. Today we're going to start with three presentations that will give us different perspectives. The first two will address particular models that have been created, and the third is going to broaden our horizon so we can see the wide variety of institutions that are relevant to this movement towards social-purpose entrepreneurship. Our first presentation will be from Bob Lang, who is the CEO of the Mary Elizabeth and Gordon B. Mannweiler Foundation and the CEO of L3C Advisors L3C. He's responsible for many innovative

projects, such as L3C, which is a new legal structure designed to incorporate socially beneficial activities under a for-profit umbrella. Bob?

>> Bob Lang: First off, I have say that the last speaker mentioned, you know, certain types of paper, and in the interest of -- You've always expressed that we have to have all sides. I want you to know we've done a survey, and parakeets are 100% against E-paper, so... [ Laughter ] And fish -- fish also have definite objections. Why are we here? In a way, we're here because -- Everybody seems to say, "Out there someplace, journalism will rise again like the phoenix." But in the meantime, journalists have to eat. Journalists have to survive. And people have to keep on getting their information because, in a democracy, if we don't have the information, we can't make good decisions. So, I think one of the reasons we're talking about -- whether it's the L3C or a myriad of other structures in the hybrid space, is because we're looking for something where we can mix new forms of investment that may be less profit-driven, to the extent of the present newspapers, where only -- You know, a few years ago, a newspaper could return a 30% return. It became a Wall Street play. "Let's see if we can merge it with three others and three others and build a conglomerate." And nobody paid attention to what was happening down on the newsroom level. So, what we're trying to do with the L3C is not just newspapers. We're working in a lot of space. And the L3C -- First of all, I'd like to put a few myths to bed here because a lot of people have come up with a lot of mistaken ideas about the L3C. First off, we are not proposing it as the cure-all for everything. There's room in this space for B Corporations. There's room in this space for a whole lot of other things. I've got two gentlemen sitting here sitting here, Allen and Rod, who are basically agnostics, who will keep looking forever for a dozen different ways. Out in California they're talking about something called the flexible corporation, and that has a lot of very interesting aspects, and it's totally for-profit. There's no hybrid purpose at all in the flexible corporation, but the idea is that there are investors out there who will put their money into something that is socially beneficial, even if they don't make as much money. So, what we did with the L3C is we said, "There's an intersection point." If you look at your spectrum along the line of investment, there's such a thing called nonprofits. These basically cannot earn their own keep, so they take donations every year from

people in order -- so, that's the minus 100%. Foundations come, give grants -- complete loss of the grant money. It's gone. It's out the window. Now, somewhere up -- and the number depends upon the risk, and I'm not going to try to cut a hard line, but it often relates to what in normal times you can get on short-term treasury notes or other types of paper. Somewhere above 5%, commercial investors will take on different kinds of investment. In between things that will only make 1%, 2%, 3%, 4% -- It's a big gap. It's a losing piece of property. But there's an awful lot of social enterprise, if you will, out there that can earn and sustain itself within that space. What's its problem? It needs working capital in order to survive because if you and I go out to set up a business, we normally try to figure what we need to operate it. We need to figure out what we need to go on if things are bad, things are good. You know, usually a lot of times there's formulas. Let's have a year or two years worth of money in the bank before we start our business if it's a new area. So, how does a business that wants to operate in a space where it can't normally get money from commercial investors get the money to create the working capital to operate? Well, let's back up into something. First off, private foundations are, for all intents and purposes, a closed-end investment trust. Now, when they are first set up, basically people got tax credits for donating their money to a foundation, and the foundation pretty much did whatever it wanted with the money. A lot of them were set up by families that wanted to keep control of a family business within the family, so they set up foundations. The kids kept running the business. The family ran the foundation, there was all sorts of little deals going on. Somewhere around 1969, Congress began to look at this and said, "This just isn't kosher. We're basically just creating a class of privileged people here who don't -- get a tax deduction, and then go on about life." So, they passed a whole set of regulations. Private foundations have to now give away 5% every year of their asset value, within -- I won't go into the details of that. But when they are creating that, some very smart lawyers from Yale -- John Simon -- and a few other places said, "Wait a minute. Sometimes you can take foundation money and put it into a for-profit, even if it's a risky venture, and you can do a lot of good with it." For example -- and it's been done over -- Gates is doing it now. Gates gives a grant to a wealthy pharmaceutical company and says, "But you have to use this grant --" And it's a grant, not even an investment, just a grant, and says, "You have to use this grant to develop a drug

for a particular, say, you know, left-handed hangnails, and there's not enough people who worry about left-handed hang nails." So, Gates gives it, and this is a legal use of grant money. There's no question. There's no issues involved. But -- So, they said, "Why don't we create this thing called PRI?" It's program-related investments. Program-related investments would be investments that are the opposite of what you should normally do with your endowment. There's all sorts of prudent investor rules for foundation endowment and all sorts of penalties against because that's another part of that regulation that came in and said, "Wait a minute. You can't just play fast and loose. You've gotten a tax deduction for this money. There's a public trust involved in this money. So, you can't play fast and loose with it anymore." So -- but you're giving -- you're taking your little 5%, and you're giving it away. There's no greater risk. There's no smaller return. You essentially walk over to the window, take the envelope, and throw it out, and whoever catches it has got a grant. So, why not say, "We could take this 5% and invest it in a for-profit if" -- and this is the big "if" -- "it actually was the opposite of what a normal endowment investment is"? It has to be a high risk or it has to be low-return or it has to be some blend of the two, and it has to perform the same kind of charitable purpose that a grant performs. Because remember -- we're replacing a grant. We are not giving you a bye to play some game. So, this tool was created. The only problem was no vehicle was ever created for this tool. Now, there's a great vehicle for most of what the foundations grant. It's called a 501(c)(3). Take your form, fill it out, fill in the blanks, send it to the IRS. They have a factory in Cincinnati that I believe -- I don't know -- I guess 25-- is it 75,000-a-year-or-something papers that you guys process down there for review, whether or not to grant 501(c)(3) status. This form -- You got a good attorney. You fill it out right. It basically promises the keep. You stay within the guidelines and the rules that the IRS has prescribed for a nonprofit. And a few months and a few dollars later, you get back your little thing with the rubber stamp, so to speak, that says, "You're now 501(c)(3)." Now, this created a safe harbor, if you will, for foundations because if, in compliance with their mission, they gave their money to a 501(c)(3), it had been more or less IRS pre-approved. Okay? This is easy. So, 95% of the foundations never made a PRI. Why should they go to the extra trouble when 501(c)(3)s exist? Well, the problem is that -- Remember we have this space in here where a lot of things could work, where a

lot of the social enterprises work, where a lot of alternative-energy -- you know, you name it. MOOMilk up in Maine, saving a bunch of farmers that otherwise would go down. These things could work if we could find ways to bring investment dollars into this space. So, when I started looking at this space, I said, "Well, the end --" Allen here, who is -- I'm going to give you the credit because -- This is a man that actually said to me, "Make it an LLC if you're gonna make it anything because LLCs have great flexibility in organization, and the organizational ability of that allows you to have greater opportunity." I says, "All right, that makes sense." So, I created the concept of the L3C. We looked at PRI regulations, and we said, "We really want to conform with those regulations. Why? Because we want to be able to make it easier to form a vehicle in this space." Now, you'll always be able to take an LLC and organize it with an operating agreement and basically go to a foundation for a PRI. That could always be done. They were one-offs. People don't like one-offs in many, many spaces in this country. One of the reasons for the flexible-purpose corporation in California is that they are trying -- they're gonna keep it a purely for-profit corporation. But one of the reasons that they will tell you is that the investment community is uncomfortable with inconsistent vehicles. They like the corporation because they know what a corporation is, and they can sell shares of the corporation. It's a good, easy way to raise money. And it's true -- corporations still go public more often than LLCs, although that's changing. But a corporation is still the form for a public entity. So, we said, "Well, at least we can, in this space, make it easier for people by coming up with a recognized name -- a brand, if you will. Coca-Cola is a lot easier. You know what it is. You want to get a Coca-Cola, you can go out and buy one. You don't have to go in your kitchen and get out a bunch of stuff and see if you can match some sort of flavor and come up with your own Coca-Cola. It doesn't eliminate any of the regulations. It doesn't eliminate any of the purposes of the IRS or any of those state regulations. In fact, one of the rules, when I got ready to set this up, was that I have to find myself an attorney that fully understands the regs so, "A," we do no harm, and, "B," we comply with all the regs. So we hired Marc Owens of Caplin & Drysdale, who, I think, was 25 years experience in the Exempt Division, 10 years of running the Exempt Division, certainly understood how to write our laws in such a way as to not in any way cause a problem. So, he did, and that's how we went off. And we

started going to various states and looking for states to pass the L3C bill, which basically provided for all the provisions of the PRI, which -- We don't have to go into the details. I ain't gonna talk about this again -- basically just that it has to be mission -- Essentially what we wanted was mission before profit, and we wanted the concept that it had to be a charitable purpose, that it was in compliance with what the IRS would normally consider charitable. So, Vermont was the first state to pass the law, and because we had grafted it as part of the LLC statute, which makes it a variant form of the LLC, it is now legal in all 50 states. Although many people don't understand this, I do not need to see another state pass tomorrow morning. We need to do no more work at any level. Anybody who wants to form an L3C has five states and two Indian tribes that they can go form them in. And that's why we essentially spend no money trying to pass the law in any other states. Every other state where it's been passed -- or where it's being worked on, I should say -- it's been local people that have -- it's grassroots movement. They've said, "We want this, and can you give us support material?" And we provide support material, but we do not expend money to try to pass these bills. However, we recognize that there are some tweaks that need to be done, and we have said all along we're perfectly willing to look at tweaks and look at changes, but you have to start from someplace. There has to be a beginning. And we've made a beginning. And that's where we want -- that's where we want to take off from. We would like to see -- I believe in the B Corporation. I think -- People have come to me and said, "Can L3Cs be B Corporations?" I said, "Why not? If you feel you need the double layer of branding, then go for it. Have fun. Be a B Corporation, too. I don't -- They're not mutually exclusive." But the whole real idea underlying this is funding. Now, let's look at funding a minute. Let's suppose we're talking about this space again between 0% and 5%. So, let's suppose that you've got an enterprise that's a social enterprise that can earn an overall -- And I'm gonna make this simple. There's a million permutations. Let's just make it simple. You can earn 5%. Nobody wants to invest and give you the working capital at 5%. It's not enough return. You have a group of investors that say, "Well, if I can get 10% and have a little better security, you'd have my money." Okay. So, here's the simple construct. We go to a foundation. We say to the foundation, "You give us 50% of the money at no return, but you still own a piece of it." And we go to private investors and say, "Okay, we can now

give you the 10% on the more secure tranche in the L3C because we didn't pay the foundation anything." So, the same pool of money now becomes 10% for that group of investors -- simple construct. This does not mean that it's a bad deal for the foundation because the foundation still has certain things. First off, foundations now give grants, and they really lose control after they give a grant. They may tell the nonprofit what they want it to do with the money, but other than the threat of no new money next year, they're pretty limited on what they can really do, unless they want to get into a really ugly fight. But if they stay as part of an L3C, they can be on a management board. They can have -- However the operating agreement is written, they can have controls, so they can ensure that it's an ongoing enterprise that continues to do what they want. If it's ever sold, if it no longer needs to be an L3C anymore, the foundation can get its money back. It can make a capital gain on it -- all perfectly legal. PRI rules have never said that they couldn't make a capital gain, they couldn't make a nice profit. It just couldn't be the original goal was to make a profit. So, with this in mind, it's a better situation for a lot of foundations, in certain kinds of things, to basically not be putting out money year in and year out for support, but to be able to put up a certain amount of money once and support a certain amount of commercial investment. And newspapers fit into this bill very nicely because the L3C is a for-profit vehicle. Now, that's another benefit. With 1.8 million nonprofits floating around -- I think you read the newspapers. A lot of towns, cities, and whatnot are getting tired of tax exemptions. They're looking and saying, "Somebody else wants to open a place and they want a tax exemption on their real estate and they want a sales tax. What are we gonna use for money to support the city anymore?" In fact, I think Pittsburgh has gone through a whole thing of trying to actually find some way of taxing nonprofits, which of course is counterproductive, but nonetheless, there's the issue here. Well, the L3C is a -- Well, okay. Don't like me anymore. The L3C is a for-profit - [ Laughs ] I have no idea how to operate it.

>> Susan DeSanti: No, no, they were supposed to fix this during the...

>> Bob Lang: Oh, okay, all right, all right. Anyway, this is now a for-profit vehicle. So if it makes a lot of money or even if it doesn't make a lot of money, it's gonna have to pay

tax on its real estate. And if it makes money as a business, then we have a situation because LLCs are normally pass-throughs, where the money gets split, according to the operating agreement, with various groups that may receive a profit and have to pay tax on it, who may not pay a tax because -- like a foundation or whatever. So, it's very flexible, very easy. With a newspaper, that's just what we need. We need a for-profit vehicle because newspapers take advertising. We don't want to get into arguments over UBIT and some of these other things. The advertising, by the way -- Does that mean my 15 minutes, which I'm over, start over?

>> Susan DeSanti: No. [ Laughter ]

>> Bob Lang: Newspapers have a lot of things they want to do. And by the way, the economic aspect of the advertising in the newspaper happens to be the important economic engine of a lot of smaller cities and towns. So, the economy might suffer more than the people if the newspaper went down in some places. I'm trying to -- [ Laughs ] Susan -- [ Laughs ] Next time she's gonna get a big clock with a gong. Anyway, so, what they're trying to do is stay as a for-profit vehicle. Now, there are some minor issues with whether or not having editorials is lobbying and the lobbying aspects of the IRS rules, and we are trying to address that with a bill that we're proposing to Congress, the Philanthropic Facilitation Act of 2010, which -- Later on, Elizabeth, you can give them kind of a rundown of that. But -- And that also will provide for a registration process for PRIs because PRIs, in essence, are nothing more than the same thing that a nonprofit is. It's promises to keep. And they could be worked out and registered in the same way with a little bit of forethought. The section on taxation of the American Bar Association last week essentially agreed with us on all points. They have issued an advisory that they're asking the Treasury to put into IRS examples that would include newspapers, would include equity kickers within PRIs, that would include a whole wide variety of activities that -- They have looked at what the IRS has approved over the last 10 years. They've looked at private letter rulings, and they've said, "You're doing this anyway. Let's put it in as an example." They have also said the L3C is a variant form of LLCs. The IRS long ago put to bed any idea that there was anything wrong with LLCs for PRIs, so therefore

we don't even feel the need to go into PRIs, so -- I mean L3Cs. So, that is it. Do you want ask questions now or later or...

>> Susan DeSanti: No, no, we'll do it during the panel.

>> Bob Lang: Okay.

>> Susan DeSanti: Thank you, Bob. [ Applause ] Okay, our next presentation is from William H. Clark Jr., who's a partner at the firm of Drinker Biddle & Reath LLP, as well as counsel to B Lab. Mr. Clark is also the reporter for a special committee for the American Bar Association business-law section that is preparing a comprehensive revision of the Model Nonprofit Corporation Act. And Mr. Clark is gonna talk to us about B Corporation.

>> William Clark: Thank you. Good afternoon, everyone. My principle topic this afternoon is actually what we're calling the Benefit Corporation, although I'll touch on B Corporations and a couple of other concepts as well. As Susan just said, I come to you because I've been representing a nonprofit organization called B Lab, and I've been working for them on a pro bono project to create a new form of corporation, which we're calling the Benefit Corporation. And a bit about terminology in a minute because you've heard a lot of different terms. I'll try to straighten that out in just a second. B Lab has undertaken an initiative to amend state corporation laws to authorize a new form of corporation, which we're calling a Benefit Corporation. Note in particular that it's a form of business corporation. B Lab itself is a nonprofit organization that first devoted its efforts to developing what they call a B Impact Assessment, which is a tool for measuring the performance of socially and environmentally responsible businesses. Any business that wants to can log on to the B Lab website, take the test, and if its self-evaluation indicates that it has a minimum score, it can go through the process of being licensed by B Lab, and then it's entitled to use the B Corporation logo and call itself a certified B Corporation. First point to note -- What I'm about to talk to you about -- Benefit Corporations -- is completely different than certified B Corporations. "Certificated B

Corporation" is simply a designation that any business can seek to obtain from B Lab, and it's simply a measurement of its environmental and social responsibilities. So, it's completely separate from the concept of Benefit Corporations. The project that B Lab has begun to amend state laws is currently at a stage where there's activity in eight states, which you can see on the chart -- California, Oregon, Colorado, New York, Vermont, Pennsylvania, Maryland, and North Carolina. California, Vermont, and Maryland are in larger logos on the screen because legislation has actually been formally introduced in those states. There's activity leaning toward or looking toward possible introduction of legislation in the other states. We're expecting that New York, Pennsylvania, and maybe North Carolina will actually see legislation introduced this year. Oregon clearly will not see anything until next year, Colorado had some initial consideration of these concepts, It will not see anything until at least next year, either. And we expect that there may be other states that will be coming online as time goes by. You might ask, "Why that particular collection of states?" The answer is it's simply because there were businesses already located in those states who are interested in seeing this concept move forward in the states. So, the legislative effort that's going on in these states is coming simply from businesses -- actually mostly certified B Corporations -- in these states. But as I said, there's legislation that has currently been introduced in California, in Maryland, and in Vermont. So, one more bit about terminology about this point. If you look at California Senate Bill 1463, you'll see that it purports to authorize what's called a flexible purpose corporation. If you read the Maryland bill, you'll see that, at the moment, it purports to authorize a B Corporation. And if you read the Vermont bill, you'll see that it purports to authorize a for-benefit corporation. We don't like the term B Corporation. We've asked Maryland to change that because B Lab is not interested in trying to enshrine in state law its own concept of B Corporations. So, Maryland will change to Benefit Corporation. Vermont has indicated that it will be changing from the for-benefit name either to just Benefit Corporation or to something else. The Vermonters love to brand things, and they may come up with their own name, maybe a 3P or who-knows-what. But we'll wait and see what comes on all of that. California, I think, is pretty well set being flexible purpose corporations. What I want to talk to you about is what's being introduced in most states, similar to Vermont, Maryland, what we're gonna see in Pennsylvania, New York. This is

not the flexible purpose corporation in California. I will tell you where California differs in just a minute. But the basic concept that B Lab is advocating is to create a subset of the notion of a business corporation, and what will define these corporations, which we're hopefully going to call, as a general matter, Benefit Corporations, is that, by statute, one of the purposes of the corporation will be to create general public benefit, as measured by an independent third-party standard. So, it's a general benefit to society and the environment, measured on some independent standard. That standard is not specified. It could be the B Impact Assessment. It could be any other standard that might be developed in the future or that a B Corporation would want to pick. The statute also says that corporations may elect to create one or more specific public benefits. And one of the differences between the California approach and benefit-corporation approach is that in California they don't have this notion of creating general public benefit, but California is saying is that, simply, you can pick one or more specific benefits that you're going to seek to promote. Other states are thinking about that as well. It's always dangerous to predict, but I think Colorado may go the way of simply focusing on specific public benefits. But the notion of Benefit Corporations, as B Lab wants to create it, is rather a focus on general public benefit with optional focus on one or more discrete purposes as well. What's important about the statutes is they say expressly that the creation of public benefit is defined as being in the best interest of the corporation. That's the linchpin of the statute because, when you go to every one of the state corporation laws, you will find that the duty of directors requires them to act in the best interests of the corporation. So, by defining public benefit as in the best interest of the corporation, it immediately has a very important affect on the fiduciary duties of directors and how they are to manage the affairs of the corporation. Last bullet on the screen can't be emphasized enough. What we're talking about is a type of business corporation. These are intended to be for-profit entities. In particular, this concept -- at least what I'm working on with B Lab -- is not tax-driven in any way. The expectation is these will be C corporations or S corporations, depending on the choice of the owners. This is not intended to get some kind of tax exemption or other public benefit. This is really an attempt simply to harness the power of the business community itself, to take a broader view of what business is all about. The specific public benefits that the statute says a corporation can elect to create include --

and this is actually language from the statutes as we're seeking to have it enacted -- providing low-income or underserved individuals or communities with beneficial products or services -- making insurance, for example, available to people that can't obtain it otherwise -- promoting economic opportunity for individuals or communities beyond the creation of jobs in the normal course of business -- we hope that most businesses are growing and prospering and will be creating jobs, but if the Benefit Corporation wants to commit, particularly to hiring handicapped, ex-cons, people traditionally unable to enter the work force, that would be a specific public benefit that could be created -- preserving the environment, improving human health, promoting the arts, sciences, or advancement of knowledge -- a lot of that should sound a lot like charitable purpose, but again, it has nothing to do with tax exemption or taxes of the entity -- increasing the flow of capital to entities with a public-benefit purpose, and then finally, accomplishment of any other particular benefit for society or the environment -- a catch-all, if you will, although, in terms of today's context, maybe we think about making sure that there's appropriate news flow in investigative journalism and an informed populous necessary for our democracy. So, possibly that last item might fit into our purposes today. The statutes then say that directors are required to consider the interest of certain other constituencies when they're making decisions as they run and manage the business. The statutes, however, also make clear that the weight that's to be given to these various interests is not prescribed. The statutes say expressly that directors must consider the interest of shareholders. That's traditionally been the sole focus of directors in business corporations. But then they must also consider the interest of employees in the work force, not only the corporation itself, but but of its subsidiaries and suppliers, customers to the extent they are beneficiaries of the public-benefit purposes of the corporation, community and societal considerations, local and global environment, and, importantly, the long-term and short-term interests of the corporation, including the possibility that those interests may be best served by the continued independence of the corporation. One particular concern is what happens when a business is faced with a very attractive offer to be acquired by someone else that would significantly benefit the shareholders but might compromise the mission of the corporation. The statute's intended to say that the money does not have to win, that the directors can consider the

possibility that it might be better for the corporation to stay independent and continue to try to accomplish its long-term goals. Now, this is a very important change in the law. A majority of states today already say that directors may consider the interests of these types of constituencies. But there is no state today that says that they must. It's purely permissive, and it's purely up to the directors to decide how much weight and which interests are to be considered. In addition to those requirements for directors, the statute also will say that an officer must consider that same list of interests that we just looked at when two things are true. First of all, the officer has discretion to make a decision. So the officer can decide "yes" or "no" in a particular instance, and that decision will have a material impact on the creation of public benefit. So, there are lots of things that officers do in the daily course of running a business that may not directly impact public benefit. We don't want them to have to think about all the constituencies all the time. But when they have discretion and when it might make a difference, the new standard will be that officers are considering the same interests I just showed you, with respect to directors. And then the corporation is required to prepare an annual report. That report is to go to the shareholders of the corporation. We'd like that report to be publicly filed with the secretary of state in the state where the corporation is incorporated. Unfortunately, we've found that Secretaries of State cannot always accommodate this additional filing and the processing of this additional report. So, some of the states are not going to require that annual report, but when they don't, they do intend to require that if a member of the public asks for a copy of the report, then the report must be given for free, without charge, to any member of the public. And then the statutes will also require that the report be publicly available on the corporation's website, if the corporation has a public portion of its website. Finally, some of the states that I just showed you on that map will probably be providing for the designation of a benefit director, who would be a director of the corporation, who will be independent, and who will be required to prepare an annual evaluation of the corporation's performance, and that evaluation -- it's intended -- will go into the annual benefit report. So, there will be someone with the express responsibility of thinking about how the corporation has done in fostering public benefit, writing a little report with their views, and that report has to be made available not only to shareholders, but will make its way into the hands of the public. In addition, some states

will also provide for a benefit officer. That person will have the responsibility for preparing the annual report, will have other duties that may be assigned by the board related to the creation of public benefit. Not every state, as we've gone through this process so far, has expressed an interest in either of these concepts, although I think some will have both. So, here's a little picture of B Lab's goal in all of this, what we call the evolution of capitalist businessman, and if you can't quite read the little scribbles at the top -- Under this view of history, from about the 10th to 18th century, we've had colonial capitalist. And then in the 19th century, we moved to the industrial capitalist. The 20th century saw the shareholder capitalist. The law, as it evolved in the 20th century, clearly made shareholders primary. That was the driving force of American capitalism. But B Lab's goal is change all of that and to move our entire economy and the capitalist system to the 21st century in the stakeholder, capitalist where business has a broader view of its mission and what it's about and a focus on accomplishing more than simply the profit for its owners. Now, I'd like to close at this point with a couple of comments about what I call the irony of corporate law. And the reason I want to talk about this is because I think it focuses very nicely on what's the really important change that's going on here. If you go back to 1983, the state where I come from, Pennsylvania, was the first state in the country to authorize directors to consider interests other than those with the shareholders. The very first what we call constituency statute came into the law in Pennsylvania in 1983. It was purely discretionary, completely optional, and its purpose, quite honestly, was simply to provide for an excuse to reject the hostile takeover. Remember, back in 1983, this was the start of the go-go years. In fact, they may be remaking the movie "Wall Street." You remember how Michael Douglas made Gordon Gekko the hero of everyone in business school. This is the time when Michael Milken is running the junk-bond market. Ivan Boesky and Carl Icahn are broad in the land. Managements were fearful because their traditional prerogatives were being threatened. And so Pennsylvania stepped in and said, "When you get in trouble, you can point to anything you want as an excuse to say "no" to the hostile takeover. Since 1983, 30 other states have followed Pennsylvania in adopting these constituency statutes. Like Pennsylvania today, as we sit here, every one of those constituency statutes is permissive. It simply says that if the directors want to, they can consider the interest of employees, suppliers, communities.

They're not required to, and the weight that they give them is completely up to the directors. It's interesting. When you read these statutes, you find, for example, that Maryland is actually honest enough to say that its constituency statute only applies in the takeover context. Maryland doesn't let you consider interest of employees, suppliers, communities, et cetera, except in the takeover context. This is the era still of shareholder primacy. We have not yet moved to the stakeholder capitalist. However, when you step back and think about it, what we're now seeing in this move toward benefit corporations in these other forms is a feeling that, in fact, maybe we got it a little bit wrong and maybe we should give more weight to these other constituencies. Maybe, in fact, it is appropriate to say that directors should take a broader view of things. So, this is where I find the great irony in corporate law. What began purely as self-interested protection of management back in the '80s has now morphed into a theoretical framework and the legal basis for an outward focus on the interest of others. We now have, in fact, evolving a different view, all coming out of management's own self-interest, but now turning us outward to consider the interests of other folks. So, thank you. [ Applause ]

>> Susan DeSanti: Thank you very much. Our third presenter is Heerad Sabeti, who is convening trustee for the Fourth Sector Network. In 1998, he led the development of the emerging fourth sector, which introduced a strategy for a new sector of organizations -- for-benefit enterprises -- Sounds very similar -- that harnessed entrepreneurial energy to shape a more just, equitable, and sustainable future. Mr. Sabeti also is co-founder and CEO of TRANSFORMS, FB, which was created as laboratory for implementation of the For-benefit organizational model. And After Heerad's presentation, then I'm gonna ask all of our panelists to come up, and we'll have a moderated discussion, along with the speakers. Heerad?

>> Heerad Sabeti: Thank you, Susan. Let's see. Okay. So, I think my role here is to sort of put the overall notion of hybrid legal entities and some of the models that have been presented into a broader context. And I'm going to start doing this by taking us to sort of a 10,000 view -- 10,000-foot view of how social and environmental and economic change happens. It's no secret that the world right now is facing a large number of

complex, intractable, and interrelated problems, from climate change to poverty to sanitation and water issues, malnutrition, lots of communicable diseases, new ones being discovered every other year, financial instability, and so on. And the scale of these problems seems to be escalating at a much more rapid rate than the scale of the solutions we have to address them. So, the big question is, "What can we do to tip the problem curve down and the solution curve up?" If you sort of click your heels together and imagine a world in some hopefully not-so-distant future where that happens -- Well -- Sorry, the slides had to get converted from a Mac to a PC, and I think we're gonna have some issues probably throughout this presentation. So, apologies for that. So, if you imagine -- You need to wear your 3-D glasses, I think, for this to make sense. [ Laughter ] If you imagine a world where we've got fewer problems of the nature we're dealing with, essentially what you have to have is a people, most of us, thinking differently and acting differently, in all the various capacities in which we act every day -- as investors, as consumers, as employees, as voters and taxpayers and volunteers. We have to behave in ways that incrementally create the sort of broader systemic conditions that we want. Well, most human activity happens through organizations, broadly defined -- So, these are, you know, these are from schools and churches to businesses and nonprofits and foundations and governmental entities. Basically, the landscape of organizations, the formal organizations, are clustered into three sector or three dominant types -- for-profit, nonprofit, and governmental. And most human activity, one way or the other, happens through those organizations. So, if we want people to be able to act -- And those organizations are designed to incentivize certain behaviors and disincentivize other behaviors. So, if we want people to think differently and behave differently, the organizations through which they behave have to be structured in a way that incentivizes the kinds of behaviors we want, right? And in many ways, that's probably different than how organizations today are structured. So, in this world, we've got people thinking differently and acting differently, and we've got organizations that are structured in a way that incentivizes those behaviors. But the problem is you can't just organize -- or you can't structure organizations independently. They're not -- Organizations are not islands. Each organization exists within a broader ecosystem of support. So, tax policy and legal forms are a piece of that, financial markets, education, and training, marketing and

communication channels. If you think about starting a business today or a nonprofit organization, there's a whole host of infrastructure, supportive infrastructure around you. You go to a lawyer or an accountant or a marketing person, and they give you advice that's consistent with what you're doing because it's part of that robust infrastructure. You can hire employees that have been trained in academic institutions that are structured to train the kinds of employees you need for that model of organization. So, if you want organizations to be structured in a way that's more consistent with the way we want people to act, we need a supportive ecosystem that's tuned to the structure of those organizations. So, basically, change has to happen at these three levels -- at the individual level, the organizational level, and the ecosystem level. Now, the good news is this change has been happening. If you take all organizations and categorize them according to their purpose, they fall on a spectrum between maximizing financial benefit to owners on one end and maximizing social benefit on the other. So, for-profits cluster on the left side of this continuum, nonprofit and government on the right-hand side. If you look at, basically, trends over the past 20, 30 years, there's been a substantial mobility of organizations from the for-profit end of the spectrum to the right. And this is evidenced by all kinds of trends, corporate social responsibility, social marketing, employee ownership, social auditing, triple bottom line, corporate philanthropy, environmental management, you know, the greening of industry, ethics, on and on and on -- huge trend of some for-profit entities sort of broadening their purpose beyond financial -- maximizing financial benefit to owners. The other interesting trend is, if you take organizations and categorize them by the way they generate their income, they fall somewhere between earning income through market exchange, which is where for-profits are, on the other end, basically relying on contributed income -- taxes, charity, grants, and so forth. And that's where nonprofits and government basically reside. So, over the past several decades, there's been a trend from the nonprofit and governmental sector towards the market, in essence. And there are lots and lots of evidence -- examples of this. The foundations are requiring a measurable impact and accountability and market discipline and efficiency and effectiveness from their grantees, social-investing movement, the program-related investments that we talked about earlier -- and I think we'll be talking a lot more about later -- and mission investing by foundations, earned-income ventures

started by nonprofits, privatization of public services, micro-finance, social return on investments, and so on. So, these are two pretty big trends, but there's an even larger trend that becomes apparent when you plot these against each other. So, basically, in this space, in the top left corner, you got a cluster of organizations that are maximizing financial benefit to owners and rely on earned income. That's where for-profits are concentrated -- and hence, the private sector. In the bottom right, you've got organizations that are relying on contributed income and pursue public purposes. So, that's where the nonprofit form resides and, therefore, the social sector, and also government and the public sector are in that space. So, from the last two slides, these are the two vectors of change. And when you look at them this way, basically, a larger trend becomes apparent. What many people have sort of remarked on over the last 20, 30 years or so as the blurring of boundaries between the for-profit and nonprofit sectors is actually -- it looks like the changes that are happening in those sectors are different. They're along different sort of axes or different vectors. What's in fact happening is the convergence of organizations towards a new organizational landscape, basically defined by the top right corner of the space, which is organizations that earn their income but pursue public purposes. And while there's been a convergence of activity towards this space, there's also been an emergence of new forms of organizations within the space. So, these are hybrid organizations that don't tidily fit into the traditional boundaries of the nonprofit, government, or private sector. Lots and lots of examples of this in the U.S. and around the world -- social enterprises, sustainable enterprises, blended-value organizations, nonprofit enterprises, common-good corporations, faith-based -- there's a lot of faith-based enterprise activity in that space -- new profits, chaordic organizations, social economy enterprises -- that's a Canadian term -- community-development corporations, community interest corp-- or companies, actually, is what they're called -- in the U.K. So, lots of examples of hybrid forms emerging in this new landscape. And collectively, basically what looks like is happening in this top-right space is the emergence of the new sector, a new fourth sector, alongside government, nonprofits, and for-profits. So, that's basically -- That's what's been happening, historically, for some time. And now if you -- if you take all this and sort of think ahead or think about the policy implications and the societal implications, what do we do about it? There's --

Arguably, a lot of the change that's happening within the sectors in this direction is a good thing, and a lot of this hybrid activity is a good thing. You've got social purposes being met through market means. And a few people sort of argue with the merits of that. But how do you formalize it? So, if you think about basically the former Soviet Union as it deconstructed, and the sort of Eastern/Central European States went from communism to capitalism, essentially what they did was they created two new sectors. They created the infrastructure for a public sector and for a social sector. So, what -- And so it's not unprecedented for a new sector to sort of be born through intentional design and effort. And sort of advocates for this activity basically, I think, believe that we need to sort of take the vector of change that's been happening for some time, and start shaping its direction by defining this new sector. And the way a sector gets defined, essentially, is there's got to be broad consensus around the archetype, the boundaries that define it, right? So, what we're talking about is a sector of organizations. And those organizations have to meet certain criteria. And from the models that were presented earlier, you know, there are some clearly well-thought-through examples of those boundaries. So, people are working on these issues. And so the idea of a for-benefit corporation is basically this broad notion that if we want to define this new emerging fourth sector, you know, maybe -- Whatever the terminologies that people land on, there needs to be broad consensus around an archetype. And so the for-benefit basically is a reference to that archetype. And there's been a number of different efforts at trying to arrive at what, you know, would define a for-benefit corporation and thus sort of set the boundary conditions for the for-benefit sector. Two criteria that consistently emerge are social purpose and business method. And that's sort of defined by the area in this chart. So, that's sort of self-evident. Other characteristics -- there's a process that we went through with the Aspen Institute and a number of experts from different disciplines back in the -- starting in the late '90s, to try to synthesize some kind of a consensus and, basically, a set of principles that would define what a for-benefit might look like. And the list of characteristics here are what came out of that process -- so, beyond social purpose and business method, this notion of inclusive governance -- I'm sorry -- inclusive ownership, and stakeholder governance, fair compensation, reasonable returns, which implies a limit beyond what would be considered reasonable, sort of baked-in commitment to social and environmental

responsibility, a commitment to transparency that's baked in, and a protection of assets, similar to what a nonprofit would have, sort of an asset log. So -- Okay. So, that's sort of looking ahead -- you know, what would it take to formalize this sector? Now, depending upon how you define its boundaries, it's -- you know, what's already happening in the fourth sector is bigger than a lot of people tend to realize. So, basically, the fourth sector is a class of organizations, a set of organizations that are -- you know, reside at the intersection of the three formal sectors. So, where the public sector intersects the fourth sector currently, you've got civic and municipal enterprises, and there's four and a half of those per city. I think that data's a few years old, and that number's growing by 30% a year. So, you see the role of numbers here. Depending how you define the boundaries, you're talking about 5% to 15% of the U.S. GDP and 10% to 20% of U.S. jobs. Where the private sector intersects the fourth sector, you've got sustainable enterprises, mission-driven businesses, employee-owned business. The nonprofit or social sector intersecting the fourth sector, you've got nonprofit-owned enterpri-- or nonprofit enterprises and community-development corporations. And then in that middle hybrid space that's sort of full of all kinds of Frankenstein legal entities that don't tidily fit into other three sectors, you've got social enterprises, faith-based enterprises, lots of hybrid forms. Co-ops fit in there, and so on. So, this just gives you a sense of the scale of activity we're talking about that could be formalized into a new sector. And then sort of bringing it home, you know, what are some industries that might find a more amenable home in a fourth-sector, were it formalized? Journalism certainly seems to be one, the marriage of social purpose with an economic or business method. Healthcare -- there's a lot of discussion about, you know, public versus private insurance, and, you know, what if there was for-benefit insurance, what if there was a hybrid that was possible between those two extremes, that have the sort of best attributes of each? Mass transit, utilities, education, banking, and so on -- so, lots of applications and lots more that I'm sure people will come up with. So, back to the first slide -- while there's lots of entrepreneurial activity out there, people are creating these hybrid forms and sort of pushing against the boundaries of their respective sector, at same time, a support ecosystem is emerging that enables all of this. So, legal forms -- we talked about several of these today -- flexible purpose corporations in California, the L3C. SR corporations was an attempt in Minnesota and

Hawaii a few years back. In the U.K., you've got community-interest companies, Canada, social economy enterprises. In Finland -- I think Finland and Italy are actually -- Those are enshrined in law, and in the U.K. The Canadian experiment sort of hasn't gone as far as it could because of some political obstacles they ran into. But anyway -- So -- But there is an active movement to create a social economy there. In terms of capital markets, there's a wide, wide, wide range of interesting things happening, sort of new forms of capital that are seeking more than just purely financial returns. So, there's a bunch of example organizations up there -- google.org and Omidyar and Skoll Foundation, Case Foundation. I think there was a "New York Times" article that called these guys "philanthpreneurs." So, a lot of the dot-com philanthropists basically had a very different approach to their philanthropy that took into consideration for-profit -- It was basically sort of a legal-form agnostic. They'd look for the social outcomes, not necessarily the legal form that delivered it. And that sort of has created a lot of the movement in the space. So social investing -- the social-investment movement has been going on for several decades. I think as of a few years ago, there was \$2.3 trillion in the U.S., and it was the fastest-growing segment of the market in the U.S. Index funds -- FTSE, Dow Jones, and S&P have all created socially motivated index funds. Community-development banking and venture capital has been a growing sector. I mentioned earlier mission- and program-related investing with foundations. There's talk about creating social stock exchanges. There's one in Brazil and one in the U.K. that's in the making, and there's folks working on creating one in the U.S. Microfinance you're all probably familiar with and so on. So basically -- Oh, and in terms of ratings and certification, trying to assess the impact of these organizations along financial as well as environmental and social, sort of factors. There's been a burgeoning of new ratings and certification schema. ISO has their own standard. We heard about the B Corp. Dow Jones is coming up with one. SBAR, inaVest, Green Plus, and a whole host of others. This is in some ways similar to how the organic-food movement sort of started out and fair trade, like fair-trade coffees. I think that the sort of path seems to be that as interest and entrepreneurship in the sector grows, you know, a whole bunch of people come in to sort of certify and bring validity to it, and then eventually the maze of validators becomes complex, and that's where I think the sort of policy needs to step in and try to clean things

up, as happened with the USDA organic standard. So this just gives a picture of what's happening in the broader ecosystem. I won't go through the rest of those. And I'm gonna close with a couple of quotes. This is Bill Gates talking at the World Economic Forum, I think three years ago. He said, "We need a creative capitalism where business and non-governmental organizations work together to create a market system that eases the world's inequities. The challenge is to design a system where market incentives, including profits and recognition, drive the change." And this is more recently the Pope in his encyclical letter middle of last year. Made some pretty strong references to this emerging sector. He said that "Traditionally valid distinction between profit-based companies and non-profit organizations can no longer do full justice to reality, or offer practical direction for the future. In recent decades, a broad intermediate area has emerged between the two types of enterprise. It is to be hoped that these new kinds of enterprise will succeed in finding a suitable juridical and fiscal structure in every country." So don't take our word for it. Thank you very much. [ Applause ]

>> Susan DeSanti: Thank you very much. Now I'm gonna ask all of our panelists to please come up.

>> Male Speaker: This is the last round?

>> Susan DeSanti: Yeah, this is the last round. I'd like to now introduce our additional panelists on this topic. Carter Bishop is a professor of law at Suffolk University Law School and a visiting faculty member at the Columbus School of Law, Catholic University of America. Allen Bromberger is a partner at Perlman and Perlman, LLP. His practice focuses on hybrid legal structures and arrangements that permit the pursuit of economic and social goals simultaneously. Steven G. Frost is a partner at Chapman and Cutler, LLP. Previously, he served as a senior counsel in the Office of Tax Policy at the Department of the Treasury in Washington, D.C., where he was responsible for the development of administrative guidance and legislative initiatives for pass-through entities. Elizabeth Grant is the attorney in charge of the charitable actives section of the Oregon Department of Justice, which she joined in 2003. We're very glad to have you

back here, because prior to joining that organization, she worked for approximately 12 years as an attorney in the FTC's Division of Marketing Practices in the Bureau of Consumer Protection. Robert Keatinge is of counsel at Holland & Hart LLP. He practices in the areas of business organizations, taxation, and professional responsibility. Elizabeth Carrott Minnigh is an attorney in the tax section at Buchanan Ingersoll & Rooney PC, where she serves as vice-chair of the firm's nonprofit organizations group. Miss Minnigh focuses her practice on nonprofit organizations, trusts and estates, and family businesses. And finally Lee T. Phaup -- I hope I'm saying that correctly -- is a senior tax-law specialist, TE/GE, rulings and agreements, Internal Revenue Service. Now, I need to make a particular comment about Lee's status, which is that she is in the position as a government representative, that she's on a very short leash. And having been in that position myself many times, there will be questions that it will seem to you it might be logical to ask the IRS representative, but we're just not going to do that, because she's not authorized to give us all of the answers that we all could want. But it's wonderful that she is here, because she can help us clarify things, and that also gives you a chance to bring back some feedback to your agency about the intense -- the intense interest in getting further guidance in some of these areas. Okay. So I'm going to start as simply as I possibly can. Because this is not that easy to understand for those of us who haven't lived our lives in this area. And if you see me going off and you think I'm getting things confused, please interrupt me. Turn your table tent up when you want to speak. And when you -- In general, when you want to speak turn your table tent up. I wanted to start with the notion of how you get tax exemption and clarify a couple of things to the extent they can be clarified. One is, okay, to be tax exempt as a 501(c)(3), an organization must be organized and operated exclusively for exempt purposes. So when I go and looked at the exempt purposes, and I went to the IRS website for this, the exempt purposes are charitable, religious, educational, scientific, literary, testing for public safety, fostering, national or international amateur-sports competition, and preventing cruelty to children or animals. And the term "charitable" is used in its generally accepted legal sense, and it includes some other things. I wanted to ask you, Steve Frost, is it now clear that newspapers have a charitable purpose?

>> Steve Frost: Can I turn it over to Lee? [ Laughter ] Well, you know, it's interesting. If I can answer you --

>> Susan DeSanti: You know what? I'm gonna ask everybody to please speak into your mikes, 'cause apparently some people were having trouble hearing before, so...

>> Steven Frost: If I can step back for a moment. You said two things, Susan, when I came in that really started me thinking this afternoon. One of the things you said is you wanted to focus on whether or not newspapers could operate in a tax-exempt fashion, which I think is driving this discussion. And the second thing you said when I walked in and we were talking with Lee for a moment, you said "This is very difficult stuff." And I'd like to kind of frame your question, if I can, with what I -- what I really think the issue is, 'cause there's a number of red herrings out there. And if you look at it in a certain way, it might be helpful. If you look at the case law and the rulings dealing with publishers and newspapers, and there have been cases, there have been IRS rulings published and private rulings, it isn't exactly clear where the line is. Publishers can operate essentially in what I would call a noncommercial manner, and they can be tax exempt. Typically, they're not gonna be profitable. And so if you look at something, the publisher or newspaper that's operating in a profitable manner, it's not likely -- or in a commercial fashion, it's not likely to be an exempt organization. And so the question I think is that I would -- There isn't a clear answer to what you're asking, but I think the question really is, what are the things that you're looking to do that you would want the tax law, as a policy matter, to achieve? Because once you identify specifically what are those things, it's a policy matter that you want to permit. Whether it's -- Examples might include enabling newspapers to raise capital by machines to print newspaper so that they could get capital loans or something like that. Once you have those things that you want to accomplish, then I think it's easier to have the discussions with Treasury and the policy people, to see if you can identify and define those things so that they can be done. Because right now, I don't think that it's clear to be done. But the other point that I was gonna make in terms of trying to keep it as simple as possible, there were several really good presentations this afternoon on Benefit Corps and L3Cs and the fourth sector,

what's going on. But I think in a sense for this narrow question, it's almost a red herring. Because when you -- Basically, if you step back, either the entity itself, the newspaper, is exempt, or the newspaper is not exempt, and what you're talking about doing is funding it through that PRI that would be made by a foundation. In either case, what you're focusing on is that the proceeds are used for an exempt purpose that we were just describing. And if the newspaper itself is not exempt, if it's an L3C, if it's a partnership, if it's a corp, it really doesn't matter. There are a number of other requirements in the tax laws, so for example, if you're making that PRI to a nonexempt entity, you have to maintain expenditure responsibility, you're going to -- as a foundation, you're gonna have to know how that money's being spent. You have to be assured that it's being spent in the exempt function and whether it's going to an L3C, whether it's going to a partnership isn't gonna matter. One last point on that, for example, I looked in the Illinois law, and if you had an L3C in Illinois, you can change its purpose. No longer be an L3C, and the only consequence is that it changes its articles. So if I'm that foundation, I'm making the loan, I need to be sure that the proceeds are being used for that exempt purpose that you've essentially identified. So I hope I've helped steer it.

>> Susan DeSanti: Okay. Well, let me go back. Okay? Let me go back and unpack some of what you said. I -- You know, if you have -- Let's take as an example, suppose you are an up -- you know, a new online news site. You're working out of your house. You and your wife are creating the news, okay? And you have advertising revenue, but heaven knows you're not profitable. You have operating revenue, but you're not really making profits. And you also accept donations. Is there guidance from the IRS on how they would look at potential for a tax-exempt status for that online news site?

>> Lee T. Phaup: We do have guidance for exempt organizations, and it's a little different. You're talking about the initial exemption application. And we do have instructions and publications out there that give you guidance as to all the tests that you must meet in order to be an exempt organization with the Internal Revenue Service.

>> Female Speaker: I didn't hear the ending. I'm sorry. Can you put the microphone a little closer?

>> Susan DeSanti: Yeah. I think in general, we're all finding this is a very quiet group. And you're gonna need to move your mikes closer.

>> Lee T. Phaup: I just said, you know, we do have publications and we do have guidance out there in addition to the instructions to the form where the exemption organization applies with the Internal Revenue Service that does give guidance as to the tests that you must comply with, both the organizational test and the operational test. So that does give guidance to organizations.

>> Susan DeSanti: Okay. But does it -- But I'm talking more broadly. I take it from what Steve -- Steve? From what you said, the -- I don't know if they're letter rulings or what that have talked about publishers and the extent to which their activities are seen as fulfilling a charitable purpose. But I took it from what you said that that's unclear. Is that correct?

>> Steve Frost: There are some cases, there are some rulings, and they come up when there's a dispute between the government and the tax payer as to the status. I don't believe that all the determination letters are published, so you don't know specifically what is qualified.

>> Lee T. Phaup: We do publish what we call private-letter rulings where somebody comes in and asks, like for instance, whether a program-related investment is okay with the service under chapter 42. But those private-letter rulings are not precedential value. So you cannot rely on them. I mean, some people use them as guidance, but you can not rely on them. We do have revenue rulings that will assist as well. But private-letter rulings that we do issue are to a specific tax payer and for a specific set of facts, but they are published under 6110. They are available to the public.

>> Susan DeSanti: Okay. Thank you. Okay, so we have -- So as far as the test of tax-exempt status, for the first criteria, it's unclear whether news organizations would necessarily be considered to be operated for charitable purposes. Okay. Next, there's a requirement that none of the earnings of the exempt organization made to any private shareholder or individual. And then there's the requirement that the organization may not attempt to influence legislation as a substantial part of -- a part of its activities, and it may not participate in any campaign activity for or against political candidates. And let me ask you, is there any guidance, even if it's in the form of letter rulings, which do not have precedential value? Is there any guidance on news organizations, and just how far they can go in terms of, you know, would reporting on legislation be considered attempt to influence legislation? If you do an analysis of the legislation, would that be considered an attempt to influence the legislation? The endorsement of candidates that is typical for news organizations. Has guidance -- Is there any type of guidance that exists right now to which someone who wanted to set up a tax-exempt news organization, could look to see, you know, how far it can go and how narrowly it has to constrain its activities with respect to legislation and political campaigns? Steve?

>> Steven Frost: The two rulings that I'm aware of whether it's --

>> Female Speaker: Could you pull the microphone --

>> Steven Frost: I'm sorry. There are two private-letter rulings that I'm aware of. One is 9551005 and the other is 200034037. And they basically addressed PRIs that were made to media organizations in other areas of the world to promote information and democracy in those areas. There's not a lot of detail in the rulings to help in understanding the limits for how that would apply. I'm not sure if other panelists --

>> Bob Lang: If I could make a comment here. I think the new puzzles for the ABA tax section, definitely they have obviously looked at a lot of what you've done, and item 16 essentially says it's time for you to include investment in newspapers into your examples as an acceptable PRI. And their analysis comment here is this proposed example

highlights the need to support for-profit newspapers struggling to exist in the age of digital media. It highlights the need for charitable dollars to support a newspaper's foreign-affairs coverage, for example, an educational resource for the general public. Also, I have here a letter from the Knight Commission, and they're raising First Amendment issues, and they're saying in the end, "In a nation with the First Amendment, we should not challenge speech in new forms of community media." And one more thing, if I can just refer to Elizabeth for three seconds, she can tell you that there are proposals in the federal law that we're proposing that would address directly the issues made, if I could bring -- Can we bring that up?

>> Susan DeSanti: Just wait a minute, Bob. We've got a lot to get through. And, yes, I know, but you are also talking about PRIs. And I'm just trying to get a very narrow, narrow issue of tax-exempt status.

>> Bob Lang: No, no, it covers both categories. It covers both nonprofit and PRIs.

>> Susan DeSanti: Okay, but we're not going there yet. I'm just trying to get an answer on the tax-exempt status and the extent to which there's guidance, and thank you, Steve, for those letters. Yes, Allen.

>> Allen Bromberger: I just wanted to speak partly from the point of view of a practitioner, and I advise clients on this stuff all the time, so let me see if I can actually give you an answer to your questions. Okay, number one is certainly you could have a newspaper as we traditionally think of them. There is -- There are lots of organizations, 501(c)(3) organizations, who create what we would call journalistic content. Some of them do distribution as well. Some of them do distribution, but they don't originate the content. So that's -- There are some distinctions there. But, for example, a couple of things. Number one is, 501(c)(3) organizations have to pay a tax on revenues that are not substantially related to their exempt purposes. This is called the unrelated business income tax. There's an IRS ruling that says advertising in periodicals is per se unrelated business income. So even though the newspaper might be tax exempt, the revenue that it

gets from advertising income will be subject to tax under UBIT. And it doesn't matter, under the existing law, whether the content of that advertising is related or not related to what the charity actually does. So that's a very important thing. And the other is that there's a whole -- There are a line of cases that say that publishing activities, publishing of books, publishing of periodicals, in and of themselves is not a charitable activity. So the creation of the news and the content may be, but if you were to set up an organization whose sole purpose it was to publish, and in this "E" era, I'm not -- we don't really know what "publish" may mean, but there's a whole world of nonprofits that are blogging and that are on Facebook and are disseminating news and information through all kinds of alternative ways on the Internet. None of them that I know of is having their tax-exempt status challenged. So I think the real question is not so much is it 501(c)(3) or not 501(c)(3). The real question is can you live within that 501(c)(3) designation and still be able to do the things that you want to do to be financially viable or to carry out your mission?

>> Susan DeSanti: That's very helpful. Thank you. Anybody else before we move on to program-related investments? Yes, Carter.

>> Carter Bishop: Well, I would just say I agree with what Allen has stated. I think I'm actually a little bit more optimistic about 501(c)(3) status for newspapers than perhaps some others may be. But that doesn't mean that I would disagree with Allen's comment that it's very difficult for a traditionally operated newspaper to live with or desire those restrictions. Only reason for a newspaper to become a 501(c)(3) is to access private capital, which is a form of public capital once it's filtered through the tax system in the form of a tax deduction. Otherwise there would be nobody that would want to live with the restrictions on exempt organization capital that exists inside an exempt organization. So that's why the other sector organizations are more attractive alternatives where the money is accessed and filtered through other exempt organizations as opposed to the principle operating entity. If that makes sense?

>> Susan DeSanti: Mm-hmm.

>> Allen Bromberger: Just one last comment, and that is the point you made about political endorsements. It's an absolute no-no for 501(c)(3)s. It's not even a gray area.

>> Susan DeSanti: Anything else? Okay. Thank you very much. All right. Lee, could you just give us the nuts and bolts of what's required for program-related investments? And then we'll -- So we have that to start out for our foundation for the discussion to come.

>> Lee T. Phaup: Okay, just to give you a little backup of it. Profit foundations, once they become exempt, are subject to what we call chapter 42 of the code. And all that encompasses is a certain code section -- 4940 through 4948. One of those code sections is 4944 -- Jeopardizing Investments. A private foundation is prohibited from investing its assets into a jeopardizing investment. You want the private foundation to use good judgment, business judgment, and prudence when it invests those assets, because you want to retain the assets to benefit the charitable constituents. An exception to Jeopardizing Investments is what we call the program-related investments. So an exception under the chapter 42 rules. In order to be a program-related investment, you need three requirements. And that's set forth in our regs at 53494-3. The first and primary requirement is that it has to substantially further the exempt purposes of the foundation. So they have to be that, you know, when you go back, you look at the articles of the incorporation or the organizing documents of your foundation and where they were first declared exempt from the Internal Revenue Service, so you need to look and make sure those purposes, you know, are furthered with this investment. The second requirement is that you can't -- If this investment is not for the primary purpose of production of income or the appreciation of property. That doesn't mean per se that if the investment makes money, it's not a program-related investment. But the purpose has to be focused on achieving the charitable purposes of the foundation. The third is no -- the investment can't be used for political or legislative activities. Another thing that I want to focus on that sometimes gets lost is that chapter 42 is a very complex section of the code. And when you're looking at it for program-related investments, other sections of the code

may be implicated 'cause they're all commingled. Like section 4941 of the code involves self-dealing and private foundations are subject to that. So you got to -- You can't just look at it in a vacuum. You need to look at all the other sections of the code. And if you violate Jeopardizing Investments, there's a two-tiered tax. It's on the foundation manager as well as on the private foundation.

>> Susan DeSanti: And could you -- My understanding is it's a very steep tax. Is that correct?

>> Lee T. Phaup: It's -- yeah, it can be steep. It's 5%. It is on the foundation manager itself in addition to the private foundation. So it's -- You want to avoid it.

>> Susan DeSanti: Okay. Okay. From what I'm hearing then, as part of a foundation figuring out whether it could make an investment that would be considered a PRI, it would have to compare that investment to the exempt purposes of the foundation itself. So it's sort of an individualized test. Is that correct?

>> Lee T. Phaup: Yes. It's very fact-specific, very heavily intensive when you look at, when we get private-letter rulings in that involve program-related investments. Yeah, we have to make sure, one, that the purposes are charitable and that it conforms to the purposes of the foundation for which it was granted exemption from the Internal Revenue Service.

>> Susan DeSanti: And one of the things that we've heard in talking with people who are thinking about these kinds of things is that foundations are sometimes leery of doing PRIs, and part of it is the cost of getting a letter ruling. And I'm wondering to what extent has it been your experience that foundations are comfortable saying, "Oh, yes, I think that I'm a -- You know, this investment that I'm gonna make is going to be a PRI, and I'm fine with the IRS"? And to what extent do you find that people want the comfort of actually having the IRS specifically look at the PRI to make sure that the IRS agrees that it's a PRI?

>> Lee T. Phaup: I think I can answer part of that and may have to defer to somebody else on the other part of that. Just to clarify, a private foundation does not have to come to the internal revenue service in order to make or enter into a program-related investment. It's good that they do just to make sure it meets our requirements, but they are not required to get a private-letter ruling. Regarding what the private practitioners think, I have to defer to somebody else.

>> Steven Frost: Susan, I had lunch yesterday with an attorney with a foundation in Chicago, and he's -- Their foundation has done over 100 PRIs, and they've gone to the Service for two or three rulings. And so the times that they went in for the rulings, where there was something very unique or unusual about the situation they were concerned about, but normally don't require it. And when I was preparing for this, I talked to one of my partners who proceeded to give me an opinion that he had given recently in a PRI in the last month or so. So I think it's fair to say -- And I did ask the foundation person I met with what his experience, and generally he told me that many people do these fields without the ruling as a normal course.

>> Susan DeSanti: Other comments on this? Yeah.

>> Allen Bromberger: Yeah, I can confirm what Steve is saying. We've talked to a very large private foundation that we work with fairly regularly, and they make internal determinations on some PRIs and get opinions of counsel with regard to others and have not felt it necessary to go in for private-letter rulings. Although they do also confirm that these are very delicate foundation-objective analyses that they undergo in the course of making the determination, whether they're comfortable that they are PRIs.

>> Bob Lang: Our conversations before we started on the L3C path were that the more comfortable a foundation got with doing this, which is what you're talking about, they got very, very comfortable. Because they developed a group of people within the foundation that understood the rules and said here's how you follow the rule book. But the real

problem comes with probably the other 75,000 foundations that are relatively small that don't have the type of internal expertise. And very often if they go to a counsel once and they don't have a regular counsel, it's gonna be an expensive proposition to get a true opinion of counsel. And so it's all over the map.

>> Susan DeSanti: Yes, Carter.

>> Carter Bishop: Susan, I might also say I think that it probably varies depending upon whether you would consider this a traditional versus a nontraditional PRI. So, I mean, the more you move away from and into the sort of zones that we're talking about today, which is a nontraditional program-related investment, the less likely it is that somebody's gonna make an internal determination, the less likely it is they're gonna rely -- a foundation manager -- less likely they're gonna rely on counsel and more likely they're gonna want some other kind of broader view from the service. So I think that's the road block.

>> Susan DeSanti: Okay. Elizabeth could you tell us the state perspective on things?

>> Elizabeth Grant: I'd be happy to.

>> Susan DeSanti: Okay. Can you get the -- Yeah. Thank you.

>> Elizabeth Grant: I think that there's been a lot of discussion about these hybrid forms but not a lot of discussion of the state rule. And to some extent, we track what IRS requirements are. But I think in some sense, it's more -- It's simpler than that. I think that if an organization or a newspaper or whatever type of organization might be represents that its purpose is to be charitable or socially beneficial. I mean, if you say you're a charity under state law, then you may be subject to state regulation as a charity under state law. And that raises a whole -- So it's fairly simple that way, you know. And there's a lot of registration and reporting requirements that apply to organizations that represent their intent to benefit charitable purposes. And so of course one of our

concerns with these hybrid forms is how -- how will those registration and reporting requirements apply. And I think if we look broadly, the purposes of those requirements is not just to collect paperwork, but traditionally, it's the job of state attorneys general to make sure that charitable organizations do not divert charitable assets or that they're not diverted to private interest and to preserve and maintain those charitable assets for the public purposes that they're intended to fulfill. So those reporting requirements are related to that objective in terms of preventing the diversion of assets and to ensuring that they're used for public purposes. And I'm gonna sort of hearken back to my days here at the Federal Trade Commission. Because I think a lot of some of what's being raised here today is actually almost akin to advertising law. I mean, because you're gonna have these entities that are out there representing that they're unique and that they're more socially beneficial and better than other forms of enterprises. And I think that the public is entitled to know the basis for those claims and to have the information available, that they'll be able to make an objective assessment about, which is the same thing that our office would be doing. I think fundamentally we're going to be looking at whether an organization is advancing charitable purposes. And when I think about how I'm going to be doing my job, it gets very -- it gets complicated in this hybrid realm. Because traditionally, one thing I know about nonprofit corporations, there's a whole body of law established, and there aren't equity interests. So I can look, and if I see that the nonprofit is distributing profits to private individuals, I can say that's the problem or that's not consistent with the law. But with these hybrid forms, I hear in some sense that, well, some amount of distribution is appropriate, but I'm not really sure what amount is appropriate. And when can you say that they're distributing too much and not furthering the charitable objectives of the organization anymore? I think in the context of newspapers for example, I think this raises interesting issues about -- Like say for example, advertising. Advertising is traditionally not a charitable purpose. So if I'm looking at something that a newspaper or a publication that claims that it's charitable, will I be looking at how much advertising is in that publication and how does that compare to the more educational value of the publication? Say, for example, and I think that the devil is in the details. And we're talking basically about how these organizations are organized. But the second and probably harder test is how they're gonna operate in real

life. And for example, can you have an operating agreement where an advertiser is an investor and says, "I'm gonna invest in your paper, but I want to make sure that I get front-page and back-page coverage." Is that advancing charitable purposes? Would that be something that our office would say, "No, that's not consistent with the charitable purposes of the organization"? And in some sense, with these hybrid forms, you're swapping out duties. The directors have duties to the shareholders in a traditional corporate form. But now they have duties to the public to use the newspapers to fulfill those public purposes. And so our role is to make sure that the directors or the managers of these new entities are in fact fulfilling those fiduciary duties. So to some extent it's simpler but also more complex and subtler than some of the tax issues.

>> Bob Lang: Actually, you've got conflicts within your own laws with some of this, because for example, IRS recognizes economic development as a -- in certain areas as part of acceptable PRIs. So if you live in Detroit, which doesn't have the newspaper coverage it used to have, you can actually make a very good case that business is being hurt by lack of newspapers in which to advertise and promote their business, and that -- So, you know, I'm not gonna say I'm gonna promote front-page advertising, but, you know, you have to start looking at the regulations, and you -- Again, what you said on, you know, the chance to regulate them. I'm gonna tell you that every state we've ever written a law for, one of the things we have proposed is that they have the right to basically take away the L3C designation if in fact they fail to comply with that, and you know what? In most states, the secretary of state has opposed that. And they said, "We don't want it." We said, "Let the attorney general do it." "We don't want to have anything to do with that. We just want to collect the money."

>> Susan DeSanti: That's understandable. Gus, do you have a question?

>> Gus Chiarello: Actually, maybe time for -- Is resolved in some of the discussion here, but, Elizabeth, in considering the hybrid organizations, and their obligations for social purposes, have you at state level and policymakers, have you considered the level of

transparency that would need to be required kind of across the board for the public and for enforcers and for the the policymakers and whatnot?

>> Elizabeth Grant: Well, I think that state attorneys generals' offices are familiar with the transparency that's required of nonprofit corporations. An we were talking about making information publicly available to journalists. And I think if you look at the nonprofit realm, charities file financial reports that are easily available on the Internet at no cost. And I work frequently with journalists to -- And we work together to sort of monitor the nonprofit sector. I think what remains unanswered is to what extent in these hybrid forms that same information will be available to the public. And I think that's something that needs to be incorporated into any legal developments in terms of making sure that that information is available.

>> Susan DeSanti: Elizabeth --

>> Elizabeth Carrott Minnigh: That is one thing that we are working for, and it's one of the reasons why we would like to get some type of federal legislation passed, is the requirement that anyone who represents themselves as being an L3C entity that is going to be receiving these PRIs make the same type of disclosures that a nonprofit organization currently makes so that that information is available to the public and also so that it's available to the IRS and the attorney generals so that they can start tracking these things and find out the people who aren't using it correctly. And, you know, B Corporations obviously are searching for that same level of transparency. So I think that's something that everybody wants. I think, you know, the big problem is gonna be finding the funding at the federal and the state level for these to be reviewed.

>> Susan DeSanti: Bill.

>> William H. Clark Jr.: If I can comment on the last point, one of the things we wrestled with is the proper role of government in all of this. And every state that I've gone to where I've talked to politicians about this new concept of a Benefit Corporation,

the first reaction we get is, "Well, we need to figure out which agency of government is gonna monitor their performance." And our immediate reaction is, no, no, you don't understand. That's the last thing that we're trying to do. Yes, it makes sense that if you're getting some public benefit, the government has to police that. But what we're trying to create is a form where it's a contract among the people who are involved. There are no tax benefits. So the government doesn't need to police. You report publicly, and the whole notion is that the light that's cast, the sunshine that has its effect to, you know, sanitize, and has prophylactic effect will be sufficient. It very much disturbs me to think that we're heading down a path here where I see the government becoming more involved. And you mentioned First Amendment. And at some point, I hope that we get around to that, because I'm sitting here thinking to myself, well, if one of the things we're worried about is the disappearance of local newspapers, what happens if we want to foster local newspapers and, to pick an extreme example, but I can see it happening, the Ku Klux Klan in a community starts to publish a newspaper. And we don't like the Ku Klux Klan. We'd be worried about what they said, but if they started out and for the first year that they're in operation, there is no discernible bias, there is no racially offensive content to the newspaper, and they are the only local newspaper in the area, why shouldn't they get the same subsidy that the government's gonna provide to another local newspaper if we go down that road? And then when we get it, who then is gonna read their newspaper every day to figure out when they finally decided they are safe enough that they can start to slant their news? I find the whole thing personally rather offensive. And I don't know whether you want to get into this, and I apologize for having missed the rest of the workshop, but it seems to me that the whole premise of this workshop is that we've conceded defeat, that we've conceded the notion that newspapers can't make it on a profitable basis, to which I say, well, is that such a bad thing? We heard a presentation about the Internet and about e-publishing. Maybe it's time to recognize that buggy-whip businesses go out of business. Maybe it's time to recognize that what we ought to do is reconfigure our broadcast laws so that media conglomerates aren't restricted in what they can do so that news comes from a different source. I think I've taken this completely off, and I'll be quiet. But I find the whole thing very troubling, and it's raised by this notion that the IRS is gonna police journalism. And if we're gonna give newspapers a tax break,

we have to, or our whole system will break down. And I'm personally offended as a taxpayer that people are gonna get a tax break if they're not entitled to it. So we have to police it, but if we police it, we destroy kind of the basis of our free society. Enough said. I'll be quiet.

>> Susan DeSanti: Okay. All right. Well, it's very -- You know, you've got -- You've challenged me, William, to try to unpack that. But let me -- Let me start. You should come tomorrow afternoon between 1:30 and 2:30 when we're going to have three presentations on the long, long history of government tax subsidies for the press. This is not a new thing at all. There are still tax subsidies having to do with print and other things, and there's a new report from the Annenberg Center for Communication Studies at the University of Southern California that goes through this in detail, has many papers associated with it. And tomorrow we're gonna hear about the history of postal-rate subsidies from the current chairman of the Postal Regulatory Commission. So there's a long history of that. Having said that --

>> William H. Clark Jr.: That's a little different than a basic tax exemption from income tax.

>> Susan DeSanti: Yeah, and --

>> William H. Clark Jr.: That's like night and day in my world.

>> Susan DeSanti: Well, you know, in my world, money is money, so --

>> Bob Lang: Microsoft just bought our screen.

>> Susan DeSanti: Yeah. So, at any rate, there are a lot of considerations that should be taken into account in any policy discussion, policy proposal, so certainly this isn't the only one that's on the table. But it is an important one that we need to understand. I think one thing that's important to keep in mind when you're talking about your benefit

corporations as opposed to these hybrid corporations, and correct me if I'm wrong, Elizabeth, but my sense is, that the -- if it's a for-profit corporation, okay, that -- as you say, William, that can be policed by the contracts among the members. Because they're not claiming tax-exempt status. So I don't --

>> William H. Clark Jr.: I don't think she'd be interested at all in a for-profit benefit corporation.

>> Bob Lang: Actually, if I can say something, I think that this time, depending on the state, that's not true. One of the battles we went through in Illinois was that clause in there for the charitable act to take effect. Because we felt the way you do. Basically the premise behind the L3C is it is a for-profit. It's a subsidized capital in a certain sense. But after that, it operates as a for-profit. I mean, so we don't belong under the Charitable Trust Act. But the Charitable Trust Act in Illinois is so broad that any for-profit corporation that operates in Illinois, technically, if it claims to do anything socially beneficial or charitable, falls under that act, and they haven't ever gotten around to enforcing it, probably for lack of money, but...

>> William H. Clark Jr.: Well, that act's wrong and needs to be amended.

>> Bob Lang: It does!

>> Susan DeSanti: Elizabeth.

>> William H. Clark Jr.: That's easy.

>> Susan DeSanti: We'll go to the state representative now. Elizabeth?

>> Elizabeth Grant: I would like to address those issues. I think for one thing, if you're not getting government subsidies, I think that PRIs is a form of government subsidy, the concerns are perhaps less. But on the other hand, I guess why is it that one wants the

certification? And I think it relates to wanting to hold oneself out to the public as being socially beneficial. And we've seen in the advertising context that charitable appeals are very appealing, that consumers react. They will buy things because of the charitable appeal. As I think there are genuine issues raised by how does one know that one's fulfilling the standards and what are those standards that are related to that certification? So the oversight might not be as extensive, but I still think that there is a need for government oversight of even for-profits that do not receive tax subsidies.

>> Susan DeSanti: Okay. And you don't think that that would be cured by transparency?

>> Male Speaker: That's the answer.

>> Elizabeth Grant: Well, it might. But who's -- I mean, what if they're not transparent? What if there's not --

>> Susan DeSanti: What if the transparency requirements were written into the law?

>> Elizabeth Grant: Well, what if they don't follow? The transparency requirements are there but say, for example, in the FCC, they don't -- you know, you could have a disclosure document that isn't accurate. So what if you have a disclosure document that doesn't actually say what's going on in the company? Who's going to -- Who's gonna watch the Watchmen, so to speak?

>> Susan DeSanti: Elizabeth.

>> Elizabeth Carrott Minnigh: I think that's the same problem --

>> Susan DeSanti: Our another Elizabeth. Yes.

>> Elizabeth Carrott Minnigh: That's the same problem with nonprofits, though. I mean, nonprofits have to disclose information on their information return, but if they lie or

withhold or misconstrue, that information isn't publicly available. So it's the same concern that is with any entity, is that the disclosure has to be accurate. I don't see that as a special concern for hybrids.

>> Elizabeth Grant: But I'm authorized to investigate and take enforcement actions against charities that engage in that kind of behavior. It's not as clear what my -- what laws are out there to protect the public from hybrids that engage in similar behavior.

>> Susan DeSanti: Okay, wait a minute. I was asking about for-profit corporations. I wasn't asking about hybrids, okay? Because hybrids, it seems to me, raise this difficult question of, is there money that is somehow flowing from the foundation into the pockets of private entity? And so -- And I took that from -- But you're saying that just for for-profit corporations that have a social purpose, it's your position that that social -- those corporations should have oversight so that the government confirms that in fact it's operating pursuant to the social purpose.

>> Elizabeth Grant: I think I'd go back to -- I think it's analogous to advertising law, that they're making representations and that there needs to be some governmental entity that can investigate the accuracy of those representations.

>> Susan DeSanti: Okay, and, William, what's your view on this?

>> William: Exactly the contrary. Transparency, we believe, is also critical. Okay. There's no question about that. And our experiment may prove to be unsuccessful, but the theory is that making the information available, particularly, for example, in a for-profit business where they're looking for an advantage in the marketplace, if a socially responsible business is competing with one that's not, and trying to attract customers based on its social responsibility, you would think that its competitor would have every incentive in the world to read its report to investigate its transparency and see if it's not behaving properly, call it on its lack of behavior. So I think -- I personally think we're making a big mistake if we want to broaden this to get the government involved. I think

that you'll meet substantial resistance from the business community that you wouldn't otherwise have without that.

>> Susan DeSanti: Okay. So now -- Okay, Bob says he agrees.

>> Bob Lang: I agree.

>> Susan DeSanti: All right.

>> William: I mean, what we're trying -- I'm sorry.

>> Susan DeSanti: Go ahead.

>> William: I wasn't completely articulate. What we're trying to do is create something that will be attractive to businesses. What we're trying to do is encourage people to come into this space in a way that is easy and that they're comfortable with, not that imposes new burdens on them. The notion that a for-profit business would be willing to subject itself to some kind of quasi-IRS scrutiny just will be the death of the concept. Heerad.

>> Heerad Sabeti: Yeah, one quick comment. I'm certainly not an advocate for owners' government oversight and intervention you know. But I think the answer is somewhere in the middle. Because already in the socially responsible business space, I mean there's been a couple of decades' worth of assessment tools and, you know, transparency mechanisms developed, and essentially what's happening now is companies shop for the best standard. I mean they shop -- Or, they create their own. I mean, they create their own label. They create their own standard. There's all kinds of ways that companies can basically, you know, sort of trick consumers into thinking that they are more responsible than they necessarily are. I don't know what the answer is. I think it's somewhere in between. I don't think you can have an onerous government, you know, process, but I also don't think you can leave it up to the free markets to do it on their own.

>> Bob Lang: Why can't you leave it to the free markets?

>> Female Speaker: I'm sorry, I can't hear you.

>> Bob Lang: I said why can't you leave most of this to the free markets?

>> Heerad Sabeti: Because the evidence so far is that there's a race to the bottom.

>> Bob Lang: Nothing's perfect. But nothing is perfect. Our whole society is based on a free-enterprise concept that the individuals are free to make choices. Now, I can give you a perfect example. You know that Buicks are good for drive-by shootings? Why are Buicks good for drive-by shootings? Because nobody remembers a Buick. It's sort of a big nondescript blob with nice big windows and all that, and you can use them for drive-by shootings. But unless you can prove that General Motors puts gun ports in the Buicks to make them especially accessible for drive-by shootings, why should you regulate Buicks in any way in relation to drive-by shootings. And I think it's the same thing. You can't regulate everything. Stuff happens.

>> Susan DeSanti: Okay. I think the record is full, is complete on this issue. Okay. Now I want to go back to the hybrid entity, and Elizabeth Grant, I'd like to go back to you, because in your discussion, I think you were highlighting this tension between, on the one hand, there's a PRI jeopardizing investment. On the other hand, there are other investors, who are getting some rate of return from their investment. It may not be 20%. But it might be 5%. and how is it that you all go through an assessment of that issue?

>> Elizabeth Grant: Well, I don't know that charitable regulators have necessarily faced that issue before. Because traditionally with nonprofit corporations, which, by the way, I think there's some misunderstanding that nonprofit corporations can't earn a profit. They can. The one thing that nonprofit corporations can't do is provide a return on equity. And I'm not sure -- I think there should be some consideration of why providing a return on equity is so important and if that's really the way to fulfill objectives. Because I think

nonprofits foundations could make PRI investments and nonprofits, just like they could make them in a for-profit. So we haven't really faced the issue of how much one can return. And some of the hybrid forms -- I know in England they have the Community Investment Corporation, which has asset-locked restrictions so that the assets aren't gonna leave the charitable sector, and some restrictions on the amount of profits that can be retained. So far I haven't seen those same concepts incorporated into legislative proposals here in the United States. So I think it raises questions about at some point the money that you're paying in private distributions could be used to make the charities stronger and to do more socially beneficial things. But I don't know where those lines are.

>> Susan DeSanti: Okay. Elizabeth.

>> Elizabeth Carrott Minnigh: I just want to make the point that one of the reasons that those haven't been pushed here in the United States is that they're having problems with them in the U.K. People aren't wanting to use the vehicle because of the restrictions. So the idea here is to create a more flexible model that people, the marketplace is gonna want to use, and maybe it needs more restrictions than we currently have in place. But if we start out with so much regulation, that nobody uses it, it's dead in the water.

>> Susan DeSanti: Can I ask you, I know that you are chairing an effort to do some expansion of the -- You know, the way I understand it, and correct me if I'm wrong, but the -- You know, what should be in the operating agreement of an L3C? And I'm wondering if you can talk a little about what else you might think about. Can you just speak into the mike?

>> Elizabeth Carrott Minnigh: We have just started. We have talked to a few people, and we're putting together a group of practitioners, we're putting together -- Some people in the U.K. have agreed to do it, including Stephen Lloyd, who sort of spearheaded the CIC movement there. We're talking to some people in Canada, and we're putting together a group of people, and we're gonna try to look at all the different models and

find out what has worked and hasn't worked and reach some kind of consensus as to how much of this can be done by getting a good model operating agreement together or a manual, best practices sort of a manual and how much of it maybe needs a little bit of regulation. And we're gonna try to look at -- You know, my hope is that we'll look from the extreme on both ends. So we haven't started yet. The insides are still putting together the group. So that's a work in progress.

>> Susan DeSanti: Okay. And let me ask you this. Here's my fundamental question about L3Cs. I understand that the specific legislation, say in Vermont, says that the L3C will include as provisions in its operating agreement the same provisions you would find for the requirements for a program-related investment in the federal tax code. Is that correct?

>> Elizabeth Carrott Minnigh: Yes.

>> Susan DeSanti: Okay. But what I think I just heard from Lee is that there has to be -- You know, that that's not enough. There has to be an individual comparison of the purposes of the particular foundation that's involved with those criteria. Is that correct?

>> Elizabeth Carrott Minnigh: That's absolutely true. It's still gonna be on a facts-and-circumstances basis for each entity. The hope is that by creating an L3C and raising awareness as to what the issues are, it'll make it easier for foundations to identify the issues they need to be looking at and to make those determinations, and they'll be more of a body of guidance out there. But they still need to look at the purposes, and they still need make that individual determination.

>> Bob Lang: I think you'd say that now exists, actually, about the 501(c)(3)s, also. If a 501(c)(3) feeds hungry children, a foundation whose chartered purpose is to support the arts is going to have trouble justifying you guys giving money to hungry children even though hungry children is an admirable trait. So it's really the same rule is carried all of the way through.

>> Susan DeSanti: Okay. Heerad, could you give us more of a sense of what you've seen in other countries in terms of the development of these types of for-benefit or benefit corporations and the kinds of -- the kinds of -- What I'm looking for really is what kinds of restrictions are there that other countries have put on them? What other types of requirements for their operation?

>> Heerad Sabeti: I mean, this is still a relatively nascent field. There's a lot of interest. I mean, some countries -- Thinking of Singapore, some Asian countries -- basically see social enterprise as a way to employ otherwise unemployable workers. So that's kind of the -- I think what happens is everybody has a different problem they're trying to solve with these new forms. And they're not all trying to solve the same problems. So depending on sort of where you look, I mean, some of these things -- And there's a cultural context that's important. In Spain, for example, co-ops are, you know, are sort of -- There's a very famous co-op called the Mondragon Cooperative. It's a large like I think billion-plus dollar, very successful commercially enterprise that's very similar in terms of its structure to a lot of what we've been talking about. And people have tried to replicate that model in different countries, and it hasn't worked because of the cultural context being different. So I don't think there's -- We actually started to do a comparative study a couple years ago with Allen's, and in turn working with him, of different approaches in different countries, and unfortunately that didn't get as far as it could have or should have. But, I mean, the issues tend to be around transparency, accountability. If there's gonna be some kind of a subsidy or incentive that the government provides, then there's got to be some commensurate accountability for that. The asset-lock issue comes up. Because of -- As you mentioned, the L3C doesn't necessarily have -- I mean, if a foundation or government is gonna put money into an entity that can be privatized, the assets for which can be privatized, that's sort of a leak that could be a problem. There's issues around legacy, banking in the commitment to social purpose, so that as management and ownership changes over time, you know, that -- the commitment is preserved. So those are some of the issues that come up.

>> Susan DeSanti: This is really embarrassing. My daughter, as usual. So... And, Allen, I wanted to follow up with you, because you have had a lot of experience working with and creating these types of entities. Could you give us some sense of your experience, and what tends to work, what tends to not work?

>> Allen Bromberger: Yeah, I can. First of all, I start from the premise that form follows function. So I agree with this notion that unless you know what you're trying to accomplish, you don't know what the right form is. And an L3C might be a perfect form for a certain type of entity with a certain type of model and a Benefit Corp and a CI. All of these are designed somewhat to do different things. But I -- There is one principle that I think is at the root of a lot of this here, which is that there's this eternal tension between mission and money and between social purpose and private profit. And we have in this country, essentially, a dichotomy of business and charity. And both culturally and to a large extent from a regulatory point of view, they're not supposed to touch each other. Nonprofits are not supposed to be commercial entities. They're not supposed to be formed for private profit. There are limits on private -- Certain types of activities are taxed, et cetera, et cetera. And businesses are supposed to be about making money, and there's a shareholder privacy document and all of the things we heard about before. And those are very deeply embedded into the existing system. So despite the fact that I describe myself as somebody who creates hybrid organizations all of the time, I almost want to say there's no such thing as a hybrid. There are nonprofits, most of which we tend to refer to as the (c)(3)s, the charities. But there are obviously lots and lots of nonprofits that are not tax-exempt and businesses of various forms and with various social motivations. And what we find is that most of the time we can't do it with a single entity. What we have to do is combine a charity and a business. And this is a very tricky area, and it's largely uncharted waters. There's lots of guidance from the IRS over many, many years about the kinds of relationships that (c)(3)s can have with for-profit businesses and vice versa. There's a whole world of cause marketing where companies want to attach themselves to charitable causes and make payments to charities and have their logos prominently displayed, commercial co-ventures where producers of goods say a percentage of your sale is gonna go to charity. Lots and lots of different kinds of

arrangements. Nonprofits, charities, they buy goods and services from for-profits all the time. Your landlord -- If you're a charity, your landlord is not likely to be a (c)(3). You're paying rent. It's a market rent, and that landlord is making money off of that lease. And so it's such a -- It's not such a clean thing, and what we have is -- So what I find is that generally what tends to work best, and, again this is painting with a broad brush, is what I would call a strategic combination of a for-profit and nonprofit so that what you have is a charity, which is a charity, and it's a charity. And it lives under rules that apply to charities, and it behaves like a charity and has to follow all rules and regulations and file all its forms with the state attorneys general and comply with life as a charity. But it has access to philanthropic dollars, tax-deductible contributions. There are ways to amass capital within 501(c)(3)s that can be then put to work. 501(c)(3)s are allowed to -- Not just private foundations with PRIs, but public charities, which is by far the largest number of charities, are permitted to make investments. They're permitted to enter into business arrangements with business, essentially as long as it's legitimately furthering its charitable purpose and they're not running afoul of the inurement rules or using their assets for the private benefit of individuals. And the business, on the other hand, operates like a business. And so it may raise its capital from private investors, and it may pay a return, and it has capital expenses, and the legal rules that apply to them are different. The accounting rules that apply to them are different. The cultural norms and expectations that apply to them are very different. People don't think of businesses and charities as being the same thing. And the real difficulty here is that we don't have enough real guidance about how you can combine these forms. Because going back to my example of content creation versus distribution, I can easily imagine a scenario under which you would want your newsroom to be a nonprofit and you would want that independence and that integrity. One of the problems that we see is that as the news media has become owned by what are essentially entertainment media companies, the traditional independence of editorial content and the reporting has eroded, and that has an effect how news gets produced and distributed and the trust with which people have in the news that they're getting. So the IRS has given some guidance in the area of joint ventures. It is pretty restrictive, and it makes it very difficult for nonprofits and for-profits to do joint ventures. But the trend is actually to loosen those restrictions. So I

think there are -- I think we're probably one or two revenue rulings away from a place that would allow a lot of this stuff to go on within certain parameters. And the same thing is true for the state attorneys general. I mean, they understand nonprofits are economic entities and they have income and they have expenses and they have to exist. You can't -- I don't care if you're a business or a nonprofit. If you're spending more than you're taking in on an ongoing basis, you're not gonna be around very long. So with that in mind, I actually, since I do get my two seconds here, I actually gave some thought to some incremental steps and things in terms of tax policy, some areas that the IRS could look at that might help to give some clarity to the kinds of arrangements that are permitted so that practitioners could do this more and PRIs would be easier to make, and all this stuff would be easier to do. Because there'd be a -- 'Cause right now, it's just totally outside of the box, and we need to kind of build the box, and then it'll be inside the box, and everybody will be comfortable dealing with it. So the first thing, ironically, is there's no definition in the tax law of what's a joint venture, or which is to say there are about 10 different definitions that apply in all kinds of different situations. Okay, so there's IRS rulings that say if there's a joint venture, this rule applies, that rule applies. None of that -- none of those rulings define a joint venture. So that's one place that we could begin, is to actually give some clarity to what these arrangements are that we're talking about. The second is that I think charities can and should have greater freedom than they do. And this is to some extent related to enter into business relationships and joint ventures and strategic partners with for-profit companies, and to me the whole trick there is what are the parameters of those relationships? What are the permissible boundaries? And I think everyone here might have slightly different versions of that, and there's a whole world of people out there who aren't at this table who would have ideas about it. I'm not saying it's easy. But I think until we have some clarity there and some parameters, as we do with PRIs and with advertising, with all these other things, it's very difficult to see how any of this stuff really moves forward in a dynamic way at any scale at all. And that's certainly true of the news business. The third thing which follows from that is to make PRIs easier and cheaper to make. Because with all due respect, although there's no requirement that you go to the IRS foundation, with the exception of those intrepid few who are making 100 PRIs -- You know, there's an organization called PRI makers, and it's supposed to be

all the foundations that make up PRIs. I don't know what their membership is today, but last year there was something like 37 foundations that had joined it that self-identified as foundations that were making PRIs on any kind of regular basis. It's a tiny, tiny fraction. But it could be much larger, and it could be a very good vehicle in a way to move philanthropic capital into these ventures, specifically to further their charitable purpose. And one of the thoughts, I think, which is kind of in line with what Bob and Elizabeth had been talking about with the L3C is thinking about some kind of safe harbor so that if you -- If you do these seven things, you're presumed to be -- to qualify. And that would make the job of practitioners much, much easier. Because we do tax opinions on PRIs, and it's really hard to do. It's really har-- Your client's gonna be entitled to rely on that, and if it turns out you're wrong and there are all kinds of tax consequences, it comes back on the lawyer. We don't write those opinions light-heartedly. And it takes a lot of work. The fourth area is I think to clarify and perhaps to give higher-level guidance. There's a lot of private-letter rulings. Very few revenue rulings, but a lot of private-letter rulings, that basically say that it is permissible for a charity to invest in for-profit ventures as a legitimate way to further their purpose. So if you're a nonprofit group and your mission is to reduce greenhouse gases and you wanted to enter into a partnership with a car company to develop a new type of fuel-cell vehicle or something like that and you look at that and you said, "We want to investment in that. That would be a terrific way for us to carry our mission forward," it happens to be taking place in a business context. Those kinds of things -- The notion that a charity doesn't just have to provide, you know, free cheese for the poor, which is a commonly held perception out there, not amongst those of us who specialize in this area -- excuse me -- among everybody else, very widely held. "What are you talking about you're doing a business? Charity's not supposed to do business." I think we need some -- We need that to be opened up. And the last two things are not strictly speaking legal, but I think they would help a lot. One of them is that I think there needs to be more outreach by the IRS into the fourth sector, into the people who are creating these businesses to talk to them from a point of view and the nonprofits that are carrying out commercial activities and all these groups that are pushing the edge of the envelope here to say what are the actual things that get in the way? Where would you draw the line? Rather than have somebody sit in the room

somewhere who is very well versed in charitable law in theory who make a set of regulations that on paper look terrific, but when you get out there in the real world, nobody can work with them. And related to that, I think, is outreach to the accounting profession. Because alongside all of this are all these business transactions and deals and money moving hither and there. And who does the 990s, and who does the financial reports, and who has to decide how these transactions are classified for tax and accounting purposes? It's all the accountants. And I'll tell you, the lawyers who are pretty far behind on this stuff are light-years ahead of the accountants. The accountants have no idea what to do with any of this stuff. And so I think those are some specific things -- And the accountants, they live and die off IRS guidance and AICPA guidance. They won't move without it. So those are, whatever, six specific things where if we focused a little bit, we could help move the ball forward.

>> Susan DeSanti: Thank you. Bob, you -- And, Elizabeth, you wanted to talk about the philanthropic facilitation act that you're proposing, which I assume is some other material that you think would help move this forward?

>> Elizabeth Carrott Minnigh: I think we've covered most of it. I mean, it's the -- You know, making that information return, creating some type of safe harbor or registration process where the IRS could look at these ahead of time so people could be somewhat assured that, you know, if people do what they say they're going to do, as with the charity, where they go in, you know, generally at the beginning and say what they're gonna do up front, that there'd be some level of assurance and a little bit of cleaning up on making sure that it's understood what the boundaries of newspapers and charity is.

>> Bob Lang: Part of this -- We've definitely put in some lines on newspapers, because I think that there's kind of a misunderstanding on newspapers. True, they may endorse a candidate, but that's not really their primary business. And to even put them into this territory -- Actually, I've always made the case that a newspaper, working in its own self-interest would actually recommend the worst candidates for election, because they create good juicy scandal stories down the road that sell more newspapers. So, you know,

lobbying and whatnot is basically a self-interest type of thing. I don't think newspapers are for self-interest. If anything, to stir up thinking process. Editorials are designed to make the people think. Let me give some further thought to this. You may disagree with it, but disagreeing is --

>> William H. Clark Jr.: The IRS disagrees with it. If you're 501(c)(3). That was the question that was the context. If you're a -- If you had a newspaper that's a 501(c)(3) endorse candidates, I don't even think it's a gray area.

>> Bob Lang: We're trying clear that point up and say it's not -- that basically what they do is not lobbying. It's not in those categories and that if they got into this space, it's not - - It really doesn't really fall within it. And the IRS, I think, also looked at newspapers a lot back in the days when there was a general rule that said any business that can be handled by the free-market sector doesn't belong being nonprofit. Nonprofit was really meant to fill a space that the free-market economy would not do. I mean, Kraft is not gonna go out hand out free cheese. So therefore you have to have somebody that buys cheese from Kraft with donated dollars and goes out and hands out the free cheese. So that's, you know, that's again, part of the bordering of money. If you can't make 30% on a newspaper anymore, maybe you need some other way to be able to get that information out there.

>> Gus Chiarello: I wanted to try to direct some questions to Robert Keatinge. If you could talk a little bit about your experience. I know you've worked in Colorado, extensively, also, in corporate design. And as we're -- Actually, when you were talking about the L3C and some of those B Corp designs, it got me thinking that from an historical perspective, maybe if we go back to the days when the LLC was being designed, what problems was that being designed to solve?

>> Robert Keatinge: You know, I think it's interesting listening to the discussion and how this is evolving, and quite frankly I know that Carter and Bill and Steve, who having working in this area -- I'm not sure that any of them go back as far as I do to the original

Uniform Partnership Act, when we were wrestling with the basic definition when organized for profit. And historically, as Allen has rightly stated, there have been two universes. There has been a for-profit universe and a nonprofit universe, with the exception of the corporate law in Delaware, Pennsylvania, where the two are in the same statute, and there's been a lot of discussion about how to go about doing exactly the kinds of joint ventures that Allen's talking about and how to facilitate people working together. And what has happened is that the LLC early on was adopted. Essentially it's going to be just like a partnership that will be two or more persons organized for profit, et cetera. And what we discovered working on any number of statutes around the country is that rather than adding additional burdens to the state law, the more we took out limitations, the more effective the vehicle became. And Carter and I did a symposium, and I talked on this very subject a year and a half ago. What didn't we think about when we came up with LLCs 20 years ago? And one of the things that nobody considered was the idea that an LLC doesn't need to be organized for profit. It's a contract. Bill and I can agree that what we wanted to do is build houses for the homeless or we want to render poor people homeless and make a profit. Rather than saying something specific in the statutes, what we ended up doing is saying an LLC can be organized for any lawful activity, essentially saying that the LLC is a very -- I like to say an LLC is a suit that gets tailored for the individual transaction. For that reason, I consider the L3C to be an abomination and have said so repeatedly. I think that it is neither necessary nor sufficient for a vehicle to have to serve as a PRI. Seems to me that if in fact the Mannweiler Foundation wanted to spend its money encouraging PRIs, perhaps coming up with more education for people and maybe even some form operating agreement would be helpful. But the attempt to say we're going to adopt a statute that is going to make PRIs bulletproof, essentially trying to change federal law through a state statute is just -- You know, it is neither necessary nor sufficient, and my reaction is that what it's doing is it's attempting to mislead people into thinking they can do something without accomplishing it. Now let me contrast that -- No, no! I've listened to you!

>> Bob Lang: A direct personal attack that you have no right making! You're putting words in our mouth. You're putting words in my mouth. You're saying what our

objectives were. You never had the courtesy in all the years that you've been doing this to ever call me, to ever e-mail me, to ever ask me a question, to never ask me what my purposes were, or to ask what the Foundation's purpose is. And I think to sit here and just make an outright attack, you are dead wrong.

>> Susan DeSanti: Okay. You've made your point, Bob. Please continue.

>> Robert Keatinge: Okay. Let me contrast L3Cs with I guess it's now benefit corporations rather than for-benefit corporations. That approach is actually attempting to solve a problem that exists in state law. Because the corporate world is set up with the concept of having a for-profit set of fiduciary duties. And that's a state-law issue that needs to be resolved at a state level. And so, for example, as I've characterized it in talks with Bill, 'cause we are considering for-benefit or benefit corporations in Colorado, what the for-benefit rules are doing are dealing with an issue that a director in a state corporation must deal with. That is, as a business corporation, the corporation is organized for the purpose of generating profit, and the director who does something that is not generating pecuniary profit runs the risk of having a state law claim of waste made against them. And unlike LLCs, which are, you know, based almost entirely on a statutory -- statutorily endorsed contract among the owners, business corporations, and Bill sometimes gets upset when I refer to them this way, are something of a procrustean bed into which the shareholders have to come without the ability to modify it by agreement. And what the benefit corporation is attempting to do is saying, "Okay, if you invest in this and you know the shareholders are going to be minimizing the profits they can make for the purpose of doing socially worthwhile things, then where you come out is that you are saying that you have bought into the fact that this may look like waste, because you could have made more money, say, using inferior products or underpaying workers or what have you, but we recognize that you're making this part of what the organization is designed to do, and I think that, you know, by giving that sort of flexibility. What that does, is that appeals to me in the newspaper area. I have absolutely no use for more pieces of paper, as those who know me can attest. But I was afraid of losing "The Denver Post," and so I went out, and I and entered into an electronic

subscription with "The Denver Post" for which I paid, even though I could have gotten the same thing for free. I wanted to promote this sort of thing. And this allows corporations to make that kind of decision and not put the directors in the position where they run the risk of having claims of waste being asserted against them. In summary, it seems to me that a lot of what I see as being the most helpful thing that the state law organizations can provide, and like Bill, I know, and most people here, we strongly believe in the federalist approach that the state should draft business-organization law in this area because it is so federally tax sensitive, be it the joint ventures between hospitals and doctors or PRIs, that the best thing that state laws can do is to get out of the way and afford maximum flexibility, letting both the state and federal regulators, regulate the tax rules. And, now, there's a second question that comes up, and that is, should the state get into the area of branding? And quite frankly, I have some reservations about that, just because unless you get to the point where the state is going to actually come up with a truly pervasive branding and enforcement scheme, which is going to put some fairly significant burdens on the state's tax coffers, which, at least in Colorado, we don't have, it seems to me that branding is far better done by independent organizations who can develop their own brand can basically collect the money that they need to collect from those who wish to obtain the branding, you know, be it the underwriters, underwriters laboratory or the B Corp, and, you know, seems to me that until you can find a way to subsidize making the branding mean something at a state level, it's misleading to put state branding into state statutes. There's are better ways to do that. But that's my perspective on this.

>> Susan DeSanti: Okay. Thank you. Carter, do you have anything else you want to add?

>> Carter Bishop: Well, generally, I think that my view, is that there are -- this is saying what Allen said, I suppose in a slightly different way. There are virtually no restrictions other than owner greed, that restrict private enterprises from being more charitable-mission sensitive. And so I think that's what Bill's effort in the B Corporation is attempting to do. The -- What Bob is trying to do is a highly more sensitive area because

of the federal regulations. It's attempting to access public capital that has become public through a tax-exemption process. And so I think that, as Allen says, unless and until the federal regulations change from this two-pot view of for-profits and not-for-profits, and if you're not for profit, you're really not for profit, and the only way that you can combine or hybridize that effort is to go through a series of laborious hoops that you don't otherwise have. Then we got a problem. And it is actually far worse, I think, for private foundations than it is for public charities, because historically I think private foundations, as Bob mentioned in his introductory remarks, a lot more difficult because of the control that private investors had over creating their own foundations. The level of abuse was larger, I think, than Elizabeth would agree, or the potential abuse was greater, and so to police that, the statute inserted a series of excise taxes which have that -- which have that sort of role. So when you talk about the PRI as a funding source, you haven't abandoned the policing that's going on first by the private foundation and secondly by the IRS over the foundation. And in addition to that, maybe state authorities as well. So you've got some heavy layers of regulation and the cork is in that area. And I think Allen's right/ If you want to create a more viable flow of capital from exempt organization area, which is another form of public funding, then you have to think through that model and whether it's -- how you want to do it.

>> Susan DeSanti: We're almost -- We're actually over time, but does anybody else have anything they want to add? I think want to thank Gus Chiarello, who's sitting next to me, who actually had conversations with all of you people. Because he's the one who put this all together, and I just, as the person who knows nothing and therefore is most qualified to say, "Wait, I don't understand. Let's start here." So thank you very much, Gus, for pulling all these wonderful people together. I really appreciate this. This is probably, certainly, for those of us who are trying to figure out journalism-type issues, this is the most explanatory conversation that we've heard, and it's very helpful, so we appreciate it.

>> Bob Lang: Thank you for having us. Thank you for having us all.

>> Susan DeSanti: Thank you. [ Applause ]

