

**A Myth Deconstructed:
The “Emperor’s New Clothes” on the Low Profit Limited Liability Company
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In 2008, the Vermont legislature enacted and Vermont’s governor signed into the law the first “low profit limited liability company” statute. Since that time, four other states have followed,² and institutions as diverse as the Federal Reserve,³ the ABA’s Real Property, Probate and Trust Section,⁴ and the Vermont Law School⁵ have given credence to the notion that the “L3C” is a socially beneficial add-on to the law of limited liability companies.⁶ Indeed, L3C

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² 2009 Ill. Legis. Serv. P.A. 96-126 (S.B. 239) (West) (codified at 805 ILL. COMP. STAT. 180/1-26 (2010)); 2008 Mich. Legis. Serv. P.A. 566 (S.B. 1445) (West) (codified at MICH. COMP. LAWS § 450.4102 (2009)); 2009 Utah Laws Ch. 141 (S.B. 148) (codified at UTAH CODE ANN. § 48-2c-412 (2009)); 2008 Vt. Acts & Resolves No. 106 (H. 775) (codified at VT. STAT. ANN. tit. 11, § 3001 (2008)); 2009 Wyo. Sess. Laws Ch. 55 (H.B. 182) (codified at WYO. STAT. ANN. § 17-15-102 (2009)).

³ Steve Davis & Sue Woodrow, *The L3C: A new business model for socially responsible investing*, COMMUNITY DIVIDEND, FEDERAL RESERVE BANK OF MINNEAPOLIS, Nov. 2009, http://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=4305 (last visited Feb. 18, 2010).

⁴ CLE presentation of the ABA Section on Real Property, Probate and Estate Law, Low-Profit, Limited Liability Companies: Facilitating Program Related Investments by Your Private Foundation Clients, Teleconference and Live Audio Webcast (Tuesday, March 2, 2010), http://www.abanet.org/rpte/meetings_cle/calendar.html (last visited Feb. 18, 2010)

⁵ Vermont Law Review, 10th Annual Symposium, Corporate Creativity: The Vermont L3C & Other Developments in Social Entrepreneurship (Feb. 18–19, 2010), <http://lawreview.vermontlaw.edu/symposia/symposia.htm> (last visited Feb. 18, 2010).

⁶ The abbreviation L3C sometimes confuses newcomers. The number “3” refers to the “L” not the “C.”

proponents have touted the device as a break-through in charitable giving, a simple, wise, and useful development in law of limited liability companies, destined to be fast-tracked for special treatment under the provisions of the Internal Revenue Code (“Code” or “IRC”) that deal with “Program Related Investments” (“PRI”) by charitable foundations.

Unfortunately, these glowing characterizations are each flatly wrong. The “L3C” is an unnecessary and unwise contrivance, and its very existence is inherently misleading. Due to technical flaws, the L3C legislation adopted to date is nonsensical and useless. Moreover, the notion that an L3C should have privileged status under the Code is inescapably at odds with the key policies that underpin the relevant Code sections. The L3C is not on track (let alone a fast track) to any special status under the Code.

Debunking “the emperor’s new clothes” should be done painstakingly, and this article therefore proceeds through several parts:

- Part I summarizes the L3C concept and the claims of its proponents.
- Part II provides background information on the limited liability company and highlights the aspects of LLC statutes that are relevant to a discussion of L3Cs.
- Part III explains the concept of the Program Related Investments.
- Part IV critiques the L3C construct and exposes its fundamental flaws under several different areas of law, including the law of limited liability companies, securities regulations, and PRIs.
- Part V concludes with a call to repudiate the L3C construct.⁷

⁷ State charity regulators have voiced serious concerns about the L3C construct. For example, the 2009 NAAG/NASCO Annual Charitable Trusts and Solicitations Conference (October 20,

Part I – The L3C Construct

On its face, L3C legislation seems simple and innocuous. The legislation amends a state’s existing limited liability company statute to create a subcategory of LLC, subject to special restrictions as to purpose and special requirements as to name. An LLC becomes a “low profit limited liability company” by proclaiming the status in its articles of organization⁸ and including in its name a special L3C designator.⁹

By statute, an L3C’s purposes are tightly restricted, and the restrictions are designed to implement the L3C’s central purpose—“to dovetail with the federal IRS regulations relevant to

2009, Austin, Texas) included a panel discussion on L3C issues, and the National Association of State Charities Officials has expressed concern that “the state L3C legislation we are seeing encourages the diversion of charitable assets away from the nonprofit sector and toward a new and untried corporate form that may lack the supervision state charity officials now exercise over true public charities.” letter of March 19, 2009, from Chris Cash, NASCO President, to Senators Max Baucus and Charles Grassley (chair and ranking member of the Senate Finance Committee), available at

<http://data.opi.mt.gov/legbills/2009/Minutes/Senate/Exhibits/jus65b04.pdf>, last visited March 5, 21010. However, the regulators’ concerns are beyond the expertise of the author and therefore detailed discussion of those concerns is beyond the scope of this article.

⁸805 ILL. COMP. STAT. 180/1-26(b); MICH. COMP. LAWS § 450.4102(2)(m); UTAH CODE ANN. § 48-2c-403(1)(c); UTAH CODE ANN. § 48-2c-412(1)(a)(i); VT. STAT. ANN. tit. 11, § 3023(a)(6); WYO. STAT. ANN. § 17-15-102(a)(ix).

⁹ 805 ILL. COMP. STAT. 180/1-10(a)(1); MICH. COMP. LAWS § 450.4204(2); UTAH CODE ANN. § 48-2c-106(8); VT. STAT. ANN. tit. 11, § 3005(a)(2); WYO. STAT. ANN. § 17-15-105(a). It appears that that L3C status is best created when the LLC is first formed. Nothing in the statutory text so requires, but the concept itself is defined as “a person organized under [the LLC statute] that is organized for a business purpose that satisfies and *is at all times operated to satisfy* each of the [highly-restrictive] requirements” of L3C status. *See* VT. STAT. ANN. tit. 11, § 3001(27) (emphasis added); *see also* 805 ILL. COMP. STAT. 180/1-5; MICH. COMP. LAWS § 450.4102(2)(m); WYO. STAT. ANN. § 17-15-102(a)(ix). Under this definition, it should be possible to form an LLC and later amend its articles to obtain L3C status, if the LLC has never operated outside the L3C strictures.

Program Related Investments (PRIs) by foundations”¹⁰—so as to allow foundations to invest some of their assets in private, profit-making enterprises formed to advance socially desirable goals. The dovetailing is evident from the language of the restrictions, which derive from the Treasury Regulations delineating permissible PRIs¹¹ and cite sections of the Internal Revenue Code. The Vermont statute, for example, establishes the following requirements for a low profit limited liability company:

(A) The company:

(i) significantly furthers the accomplishment of one or more charitable or educational purposes within the meaning of Section 170(c)(2)(B) of the Internal Revenue Code of 1986, 26 U.S.C. § 170(c)(2)(B);¹² and

(ii) would not have been formed but for the company's relationship to the accomplishment of charitable or educational purposes.

(B) No significant purpose of the company is the production of income or the appreciation of property; provided, however, that the fact that a person produces significant income or capital appreciation shall not, in the absence of other

¹⁰ What is the L3C?,

<http://www.americansforcommunitydevelopment.org/supportingdownloads/BasicL3CExplanation-History.pdf> (last visited Feb. 8, 2010).

¹¹ The regulations appear at 26 C.F.R. § 53.4944-3 and are discussed *infra* Part III.

¹² The cited section of the IRC defines the term “charitable contribution” as *inter alia* “a contribution or gift to or for the use of . . . [a] foundation . . . organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals.” 26 U.S.C. §§ 170(c), 2522(a)(2).

factors, be conclusive evidence of a significant purpose involving the production of income or the appreciation of property.

(C) No purpose of the company is to accomplish one or more political or legislative purposes within the meaning of Section 170(c)(2)(D) of the Internal Revenue Code of 1986, 26 U.S.C. § 170(c)(2)(D) [influencing legislation and elections].¹³

Although by statute an L3C must have a charitable or educational purpose,¹⁴ the L3C's *raison d'être* is to combine foundation money with money from entrepreneurial investors.

The central premise of an L3C's operation is its use of low-cost capital in high risk ventures and its ability to allocate risk and reward unevenly over a number of investors, thus ensuring some a very safe investment with market return. As is appropriate under the PRI structure, foundations could assume the top risk at very low return, making the rest of the investment far more secure.¹⁵

¹³ VT. STAT. ANN. tit. 11, § 3001(27)(A)–(C). *See also* 805 ILL. COMP. STAT. 180/1-26(a)–(b); MICH. COMP. LAWS § 450.4102(2)(m); UTAH CODE ANN. § 48-2c-403(1)(c); WYO. STAT. ANN. § 17-15-102(a)(ix).

¹⁴ It is unclear whether the referenced L3C statutes exclude from an L3C's permissible purposes the items listed in 26 U.S.C. § 170(c)(2)(B) other than educational and charitable purposes. For example, might an L3C be properly formed to own and operate an animal shelter?

¹⁵ Americans for Community Development,
<http://www.americansforcommunitydevelopment.org/about.html> (last visited Feb. 18, 2010).

Thus, an L3C exists to (i) receive foundation money through the PRI mechanism and then (ii) leverage that money with investments from for-profit private investors. As a matter of regulatory law, L3C proponents claim that L3C status will streamline the PRI process.¹⁶ As a matter of finance, L3C proponents extol the benefits of “tranching investing” as a means of social change.¹⁷ The L3C construct:

facilitates tranching investing with the PRI usually taking first risk position thereby taking much of the risk out of the venture for other investors in lower tranches. The rest of the investment levels or tranches become more attractive to commercial investment by improving the credit rating and thereby lowering the

¹⁶ This claim is de-bunked *infra* Part IV. The principal proponent of the L3C appears to be Robert Lang and Americans for Community Development, an L3C created by Mr. Lang. See <http://www.americansforcommunitydevelopment.org/> (last visited Feb. 18, 2010). According to that website: “Americans for Community Development was formed to turn the L3C into a major force in American philanthropy to better meet the mission of helping communities and the people who live there throughout the world. The L3C is a new form of limited liability company (LLC) that combines the best features of the LLC with the social conscience of a non-profit. Robert Lang, CEO of The Mary Elizabeth & Gordon B. Mannweiler Foundation, Inc. who created the L3C, calls the L3C ‘the for profit with a non profit soul.’” *Id.* See also Cassady V. Brewer & Michael J. Rhim, *Using the ‘L3C’ for Program-Related Investments*, 21 TAX’N OF EXEMPTS 11, 13 (2009) (“[The ‘L3C’] was conceived by Robert Lang, CEO of the Mary Elizabeth & Gordon B. Mannweiler Foundation, with assistance from Marcus Owens of Caplin & Drysdale.”)

¹⁷ State regulators, among others, are skeptical of this claim. For example, the 2009 NAAG/NASCO Annual Charitable Trusts and Solicitations Conference (October 20, 2009, Austin, Texas) included a panel discussion on L3C issues. See also Letter from Chris Cash, President, Nat’l Ass’n of State Charity Officials, to Senate Fin. Comm. (Mar. 19, 2009) (regarding L3C legislation); David Edward Spenard, *Panacea or Problem: A State Regulator’s Perspective on the L3C Model*, 65 EXEMPT ORG. TAX REV. 131, 133 [hereinafter Spenard, *Panacea or Problem*] (“The claim that the L3C Model will open floodgates that are holding back access to billions if not trillions of dollars of investment, a major selling point for the model, warrants skepticism.”) (footnote omitted).

cost of capital. It is particularly favorable to equity investment. Because the foundations take the highest risk at little or no return, it essentially turns the venture capital model on its head and gives many social enterprises a low enough cost of capital that they are able to be self sustainable.¹⁸

Note that the foundation creates the financial base for the project, making a high-risk/low-gain investment rather than a more traditional grant. Additional capital comes from sources seeking to make at least some profit.

Proponents of the L3C have high hopes for its utility and impact. According to these proponents, before the L3C, foundations had to move cautiously when considering PRIs and the transactional costs of making a Program Related Investment were high. Consequently, PRIs were not common, and certainly did not provide a major impetus to socially beneficial investing. With the L3C in place, L3C proponents predict substantial change:

The L3C . . . makes it very easy for lawyers and laymen alike to grasp since it does not create a new structure but merely amends the definition section of the llc [sic] acts in most states. . . . Probably more importantly than anything else, the

¹⁸ Americans for Community Development,
<http://www.americansforcommunitydevelopment.org/about.html> (last visited Feb. 18, 2010).

L3C is a brand which stands for all this and more and hopefully as a brand will make the concepts easy to grasp and thereby frequently used.¹⁹

Part II – The Limited Liability Company Explained

For most intents and purposes, the LLC did not exist as a viable entity until 1988, when the IRS acknowledged that:

- its “Kintner” tax classification regulations meant what they said, and
- Wyoming’s then novel creation—the Wyoming limited liability company—would be taxed as a partnership, even though none of the company’s owners had anything like a general partner’s automatic liability for the company’s debts.²⁰

Today, every state has an LLC statute, and almost everywhere in the country new LLC formations far outnumber new corporate formations. Except in unusual circumstances, the LLC has become the “vehicle of choice” for new business formation. Moreover, large, publicly-traded corporations increasingly use single member limited liability companies to serve as wholly-owned subsidiaries.²¹

¹⁹What is the L3C?, <http://www.americansforcommunitydevelopment.org/supportingdownloads/BasicL3CExplanation-History.pdf> (last visited Feb. 18, 2010).

²⁰ For an overview of this history, see DANIEL S. KLEINBERGER, AGENCY, PARTNERSHIPS, AND LLCs: EXAMPLES AND EXPLANATIONS 461–65 (3rd ed. 2008). For a more detailed account, see CARTER G. BISHOP & DANIEL S. KLEINBERGER, LIMITED LIABILITY COMPANIES: TAX AND BUSINESS LAW ¶ 1.01 (1994, Supp. 09-2) [hereinafter Bishop & Kleinberger, Limited Liability Companies].

²¹ See Bishop & Kleinberger, Limited Liability Companies ¶ 4.02; see also Rex Blackburn, *The New LLC Act Preserves Idaho’s Traditions*, 52 ADVOC. 16, 16 (2009); Heather M. Field, *Checking In on “Check-the-Box”*, 42 LOY. L.A. L. REV. 451, 485–87 (2009).

It is commonplace to characterize the LLC as a hybrid entity, an overlap of partnership and corporate constructs. The Wyoming Supreme Court, for example, has stated that “limited liability companies are a conceptual hybrid, sharing some of the characteristics of partnerships and some of corporations.”²² The federal district court in Delaware has characterized LLCs as “hybrid entities that combine desirable characteristics of corporations, limited partnerships, and general partnerships,”²³ and the California Court of Appeals has noted that “[a]n LLC is a hybrid entity that offers certain advantages over corporations and partnerships, by combining aspects of each.”²⁴

“The essence of an LLC is the co-existence of partnership tax status with corporate-like limited liability.”²⁵ The great advantage of the LLC is its ability to resolve the “tax shield conundrum:”

Before the advent of the LLC, it was impossible to have both the tax status of a partnership and the liability shield of a corporation. In effect, entrepreneurs who wanted the complete, corporate shield had to pay some form of tax cost for this protection. In its simplest manifestation, that cost consisted of double taxation of a business's profits. An ordinary C corporation is a taxable entity; it pays dividends out of its after-tax “earnings and profits.” Those profits are then

²² *Lieberman v. Wyoming.com LLC*, 11 P.3d 353, 357 (Wyo. 2000). For a more nuanced approach to this issue of characterization, see Daniel S. Kleinberger, “The LLC as Recombinant Entity – Revisiting Fundamental Questions through the LLC Lens,” *Proceedings of the 21st Century Commercial Law Forum – Seventh International Symposium 2007 (Beijing, China)*, published in 14 *FORDHAM J. CORP. & FIN. L.* 473, 473 (2009) (stating that “an LLC combines attributes of four different types of business organizations: general partnerships, limited partnerships, corporations, and closely held corporations”).

²³ *Great Lakes Chem. Corp. v. Monsanto Co.*, 96 F. Supp. 2d 376, 383 (D. Del. 2000).

²⁴ *Nw. Energetic Servs., LLC v. Cal. Franchise Tax Bd.*, 159 Cal. App. 4th 841, 852, 71 Cal. Rptr. 3d 642, 649 (2008).

²⁵ Bishop & Kleinberger, *Limited Liability Companies* ¶ 1.01[1].

generally taxed again in the hands of the shareholders when distributed to them in the form of dividends.

Partners avoid this double-taxation because partnerships are not taxable entities. Partnership profits (whether distributed or not) are deemed to pass through to the partners, at which level they are taxed but once. Partners can also benefit directly from partnership losses, which also pass through and can serve as deductions for the individual partners. In contrast, the losses of an ordinary corporation stay with the entity, and are thus useful only if the entity later enjoys a profit. Partnerships are also advantageous in other realms, including the treatment of a partner's basis in his interest.

The problem with partnerships has, of course, been personal liability. Prior to the advent of limited liability partnerships and limited liability limited partnerships [developments that followed the advent of LLCs], at least one partner of every partnership had to be liable for the business's debts—thus the tax-shield conundrum.²⁶

In the early days of LLCs, tax classification constraints produced a “family resemblance” among most LLCs,²⁷ but in 1997 the IRS’s “check the box regulations” eliminated all connection between an LLC’s structure and the entity’s eligibility for partnership tax status.²⁸ There remain, however, certain essential characteristics of the LLC. “A creature of state law, each LLC is organized under an LLC statute that creates the company, gives it a legal existence separate from

²⁶ Bishop & Kleinberger, *Limited Liability Companies* ¶ 1.01[2] (footnotes omitted). “Work-arounds” existed before the advent of LLCs, most notably S Corporations and limited partnerships, but each work-around carried its own problems. *Id.*

²⁷ DANIEL S. KLEINBERGER, *AGENCY, PARTNERSHIPS AND LLCs: EXAMPLES AND EXPLANATIONS* 462–63 (3rd ed. 2008).

²⁸ For a detailed discussion of the “check the box” regulations, see Bishop and Kleinberger, *Limited Liability Companies*, ¶¶ 2.01–2.08. The Sixth Circuit upheld the constitutionality of the IRS’s radical change in *Littriello v. United States*, 484 F.3d 372 (6th Cir. 2007). Thomas E. Rutledge & Scott E. Ludwig, *The Sixth Circuit Affirms Littriello: “Check-the-Box Regulations are Upheld*, 106 J. TAX’N 325 (2007).

its owners (called ‘members’), shields those members from partner-like vicarious liability, governs the company's operations, and controls how and when the company comes to an end.”²⁹

Under all LLC statutes, the rules governing relations among the members and the LLC are almost entirely “default” rules—i.e., subject to change by agreement among the members. The members’ agreement is typically called the “operating agreement,” and the operating agreement is the “cornerstone” or “chartering agreement” of each LLC.³⁰ According to the official Comments to the Revised Uniform Limited Liability Company Act, “an LLC’s operating agreement serves as the foundational contract among the entity’s owners,”³¹ and “flexibility of management structure is a hallmark of the limited liability company.”³²

Part III – Program Related Investments (PRI) Explained

²⁹ Fashion Valley Mall, LLC v. County of San Diego, 176 Cal. App. 4th 871, 875, 98 Cal. Rptr. 3d 327, 330 n.1 (2009) (quoting Bishop & Kleinberger, Limited Liability Companies ¶ 1.01[1]) (footnotes omitted).

³⁰ These characterizations come from Delaware courts, referring to Delaware LLCs. *See* Elf Atochem N. Am., Inc. v. Jaffari, 727 A.2d 286, 291 (Del. 1999) (cornerstone); Haley v. Talcott, 864 A.2d 86, 94 (Del. Ch. 2004) (chartering agreement). Another Chancery Court opinion is even more emphatic: “[L]imited liability companies are creatures of contract, designed to afford the maximum amount of freedom of contract, private ordering and flexibility to the parties involved. To the extent defendants intend to argue otherwise, plaintiff need not offer a rebuttal.” TravelCenters of Am., LLC v. Brog, Civ. Action No. 3751-CC, 2008 WL 5272861, at *1 (Del. Ch. Dec. 5, 2008) (quotation marks and footnote omitted). However, the situation is essentially the same under all other LLC statutes. *See, e.g.*, Rev. Unif. Limited Liability Co. Act [hereinafter Re-ULLCA] § 110(a) (providing that, subject to a limited list of specific exceptions, the operating agreement governs: “(1) relations among the members as members and between the members and the limited liability company; (2) the rights and duties under this [act] of a person in the capacity of manager; (3) the activities of the company and the conduct of those activities; and (4) the means and conditions for amending the operating agreement.”).

³¹ Re-ULLCA, Prefatory Note, Noteworthy Provisions of the New Act, Operating Agreement.

³² Re-ULLCA § 301(a), Cmt.

In order to understand the nature and importance of PRIs, it is first necessary to understand the status of foundations under the IRC and the protective limitations the Code and Treasury regulations impose on foundations.³³ In particular, it is necessary to understand the prohibitions on speculative investments and the requirement that foundations annually distribute a specified portion of their assets.

Private foundations enjoy tax exempt status³⁴ and exist within a myriad of tax regulations designed to protect charitable assets from imprudent management and diversion to the benefit of non-charitable purposes or private persons.³⁵ These regulations have strong teeth; contravention

³³ For a detailed analysis of this topic, see Carter G. Bishop, *The Low Profit Limited Liability Company (L3C): Program Related Investment Proxy or Perversion*, U. ARK. L. REV. (forthcoming 2010) [hereinafter Bishop, Proxy or Perversion]. For a discussion of exempt organization commercial activity and joint ventures, see Bishop & Kleinberger, *Limited Liability Companies* ¶ 1.09.

³⁴ This status allows donors to deduct contributions. I.R.C. §§ 170(a)(1) (permitting a deduction for any charitable contribution made within the taxable year), 170(c)(2)(B) (defining “charitable contribution” to include those made to or for the use of Section 501(c)(3) organizations). Moreover, “[t]raditionally, real estate owned by charities is exempt from real estate property taxes.” Bishop & Kleinberger, *Limited Liability Companies* ¶ 1.09 n.1453.

³⁵ 26 U.S.C. § 501(c)(3) (providing tax exempt status for specified organizations “organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual”); Treas. Reg. § 1.501(c)(2) (“An organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.”). The regulations are also intended to protect the commercial realm from unfair competition from enterprises that benefit from tax exempt status. E.g. Clarence LaBelle Post No. 217, *Veterans of Foreign Wars of U.S. v. U.S.* 580 F.2d 270, 277 (8th Cir. 1978) (stating that “[t]he legislative history of the unrelated business income tax provisions clearly establishes that the provisions were enacted with the primary objective of eliminating unfair competition between exempt and non-exempt organizations”); *Florida Hosp. Trust Fund v. C.I.R.*, 103 T.C. No. 10, 103 T.C. 140, 159 (U.S. Tax Ct. 1994) (applying IRC § 501(m) [Certain Organizations Providing Commercial-Type Insurance Not Exempt From Tax] and quoting the House committee report as follows: “The committee is

brings excise taxes so heavy that one expert has described them as “toxic.”³⁶ Speculative investments and investments for improper purposes are “jeopardizing investments.”³⁷ Jeopardizing investments trigger substantial excise taxes, not only for the foundation³⁸ but also “on the participation of any foundation manager in the making of the investment, knowing that it is jeopardizing the carrying out of any of the foundation's exempt purposes.”³⁹ Moreover, “private inurement” (i.e., benefits to ineligible purposes or persons) can destroy a foundation’s tax exempt status,⁴⁰ and, in theory at least, this prohibition has “zero tolerance.”⁴¹ In addition, foundations face nearly confiscatory taxes to the extent they fail to properly distribute at least five per cent of their assets annually.⁴²

The strictures provide the context in which PRIs make sense. The function and virtue of a Program Related Investment is:

concerned that exempt charitable and social welfare organizations that engage in insurance activities are engaged in an activity whose nature and scope is so inherently commercial that tax-exempt status is inappropriate. The committee believes that the tax-exempt status of organizations engaged in insurance activities provides an unfair competitive advantage to these organizations.”).

³⁶ Bishop, Proxy or Perversion.

³⁷ 26 C.F.R. § 53.4944-1(a)(2).

³⁸ 26 C.F.R. § 53.4944-1(a).

³⁹ 26 C.F.R. § 53.4944-(b).

⁴⁰ *United Cancer Council, Inc. v. Comm’r*, 165 F.3d 1173, 1179 (7th Cir. 1999) (citing *Better Bus. Bureau v. United States*, 326 U.S. 279, 283 (1945)).

⁴¹ “The prohibition against private inurement, in contrast . . . and the amount and extent of such inurement is not determinative.” *Wendy L. Parker Rehab. Found., Inc. v. Comm’r*, 52 T.C.M. (CCH) 51, n.2 (1986) (citing *Church of the Transfiguring Spirit v. Comm’r*, 76 T.C. 1, 5 (1981)). For a more detailed explanation, see Bishop & Kleinberger, *Limited Liability Companies* ¶ 1.09[1][c][i][A] Private foundations must also comply with an independent, non-tax, but conceptually parallel regime of state law regulation. *See Spenard, Panacea or Problem*, at 131.

⁴² 26 U.S.C. § 4942(d)–(e).

- to permit private foundations to make investments, rather than grants, in mission-appropriate enterprises;
- without the investments being considered speculative or otherwise “jeopardizing;”
- with the investments counting toward the minimum annual payout required of foundations.⁴³

However, the enabling regulations are strict:

A program-related investment is an investment which possesses the following characteristics:

- (i) The primary purpose of the investment is to accomplish one or more of the purposes described in section 170(c)(2)(B) [charitable purposes] ;
- (ii) No significant purpose of the investment is the production of income or the appreciation of property; and
- (iii) No purpose of the investment is to accomplish one or more of the purposes described in section 170(c)(2)(D) [influence legislation/elections].⁴⁴

Although at first glance all three requirements seem generic, the first requirement is actually foundation-mission specific:

⁴³ Treas. Reg. §§ 53.4944-3 (regarding jeopardizing investments), 53.4942(a)-3(a)(2)(ii) (recognizing program related investments as qualifying distributions to satisfy the five percent requirement).

⁴⁴ 26 C.F.R. § 53.4944-3(a).

An investment shall be considered as made primarily to accomplish one or more of the purposes described in section 170(c)(2)(B) if it significantly furthers the accomplishment of the private foundation's exempt activities and if the investment would not have been made but for such relationship between the investment and the accomplishment of the foundation's exempt activities.⁴⁵

Consequently, each time a foundation considers making a Program Related Investment, the foundation must make a situation specific determination that takes carefully into account the foundation's mission, the purpose of the organization receiving the investment, the relationship of the receiving organization's purpose to the foundation's mission, and how the governance and financial structure of the receiving organization insures that the receiving organization will operate within the PRI requirements. At minimum, the last-mentioned issue requires the foundation to carefully monitor the activities of the receiving organization.⁴⁶ Prudence likely requires some substantial amount of control.⁴⁷ Either way, devising a PRI arrangement requires careful and individualized investigation, deliberation, negotiation, and drafting. An opinion of

⁴⁵ 26 C.F.R. § 53.4944-3(a)(2)(i) (emphasis added).

⁴⁶ Treas. Reg. § 53.4944-3(a)(3)(i) states that “an investment which ceases to be program-related because of a critical change in circumstances shall in no event subject the foundation making the investment to the tax imposed by section 4944(a)(1) before the 30th day after the date on which such foundation (or any of its managers) has actual knowledge of such critical change in circumstances.”

⁴⁷ Bishop, Proxy or Perversion, at n.132 (stating that “presumably the controls granted by the foundation over the LLC guaranteed that the foundation would exercise proper expenditure oversight authority to negate the Section 4945 taxable expenditure tax”).

counsel is almost *de rigueur*, and prudence sometimes warrants seeking a private letter ruling from the IRS.⁴⁸

The IRS has issued only one public ruling on PRIs, involving “a fairly innocuous private foundation low interest rate loans to blind persons to allow them to establish their own businesses.”⁴⁹ To date, the IRS has issued only one private letter ruling concerning a PRI to a limited liability company. The ruling described a receiving organization subject to substantial ongoing control by the investing foundation.⁵⁰

The private letter ruling did not pertain to an L3C and did not involve the use of program related investments as a lure for investors seeking a full market rate of return. Indeed, the type of tranching investments advocated by L3C proponents is novel for PRIs,⁵¹ and, as explained below,

⁴⁸ Bishop, *Proxy or Perversion*, at _____. See also Spenard, *Panacea or Problem*, at 133 (“Perhaps the reason many private foundations approach some PRI transactions with caution is that they realize arrangements between charitable entities and for-profit entities can be very complex, and intentionally investing assets in their portfolio into transactions expected to produce below-market returns is inherently risky. The reason many private foundations seek private letter rulings may be because they understand that PRI transactions which push the envelope in terms of producing income or the appreciation of property should be approached with caution.”). Compare the attitude of insouciance expressed on the website of the L3C’s principal proponent: “We honestly believe if an L3C is used and the IRS regulations are followed there will not be an issue. No one asks permission to drive the posted speed limit why ask the IRS if you can follow their regulations?” *PRIs and Private Letter Rulings*, <http://americansforcommunitydevelopment.org/supportingdownloads/PrivateLetterRulings.pdf>, last visited March 4, 2010.

⁴⁹ Bishop, *Proxy or Perversion*, at n.131 (citing Rev. Rul. 78-90, 1978-1 C.B. 380).

⁵⁰ Priv. Ltr. Rul. 200610020 (March 10, 2006).

⁵¹ The IRS has issued other private letter rulings concerning Program Related Investments into other forms of business organization, but none of those rulings pertained to tranching investments. Nonetheless, despite the absence of any IRS rulings on either L3Cs or the tranching investment approach, an L3C proponent has chastised an IRS official for “your assertion that the Service has not yet considered the federal tax implications of foundation investments in L3Cs” and has stated that the assertion “is not entirely accurate and, in fact, may be misleading.” Letter from Marcus S. Owens, Caplin & Drysdale, to Ronald Schultz, Senior Tech. Advisor, Tax

the tranche approach raises conflict of interest issues between foundation and market-oriented investors.⁵² This tension increases the need for careful, situation-specific planning by foundations considering making a program related investment into a tranching low profit limited liability company.

In addition, the tranche approach creates special risks of private inurement, which likewise require careful forethought, planning, and monitoring. Depending on how much an L3C is tilted toward the market-rate investors, the investing foundation risks being seen as benefitting—even as a side effect—substantial numbers of individuals distinct from the foundation’s purpose. In that situation, the foundation’s benevolent purpose will not save it from a private inurement problem.⁵³

Exempt & Gov’t Entities Div., Internal Revenue Serv. (July 8, 2009), *available at* http://americansforcommunitydevelopment.org/downloads/im4511_20090701_173540.pdf.

⁵² The approach also concerns regulators. “It is important to point out that ‘low profit’ in the context of an L3C does not necessarily describe a situation in which each participant investing in the venture is agreeing to a low-profit or below-market return. Rather, the L3C provides a structure through which there is an uneven allocation of risks and expected returns.” Spenard, *Panacea or Problem*, at 132.

⁵³ *Canada v. Comm’r*, 82 T.C. 973 (1984), is instructive here. As explained by the Court:

Respondent [IRS] contends that the KLCC [Kneadmore Life Community Church] was operated to a substantial degree for nonexempt purposes in that it benefited private interests. Specifically, respondent points out that community members could live on, raise animals and grow crops for personal consumption and for sale on, and conduct businesses on, community land without paying rent to the KLCC and that the KLCC carried on communal activities such as community gardens and orchards and communal use of KLCC farm equipment and seeds. Moreover, students (or ex-students) from Indiana University were often drawn to the community for the purpose of exploring alternative lifestyles.

Id. at 982. The Tax Court ruled against KLCC, despite “accept[ing] the sincerity of the beliefs of the members of the KLCC, the religious character of their beliefs, and the assertion that the KLCC was their chosen instrument alike for furthering their beliefs.” *Id.* If a tranching L3C tilts

In sum, when a foundation considers making a PRI, prudence requires a careful, individualized, and professional approach, even (perhaps especially) when the proposed receiving organization is an L3C.⁵⁴

Part IV – The L3C Concept Debunked

L3C proponents see the low profit limited company almost as a conceptual messiah, come to lead charitable giving and socially conscious investors to a new Jerusalem.⁵⁵ The homepage for Americans for Community Development features a changing banner that lists “just a few of the ways the L3C can help,” and those ways include:

to save existing farms . . . help an otherwise struggling company in today’s competitive environment or . . . buy an empty factory, re-equip it to be a source for many jobs . . . make a museum or other non-profit self sufficient . . . address

too heavily toward the market-oriented investors, the private benefit analysis may be analogous. For a further discussion of this issue, see Bishop, Proxy or Perversion at ____.

⁵⁴ See Treas. Reg. § 53.4944-1(a)(2)(i), (b) (articulating standards of knowledge, care, and appropriate reliance on legal opinions).

⁵⁵ E.g., Cassady V. Brewer & Michael J. Rhim, *supra* note 16, at 19 (“The arrival of the L3C potentially is a watershed moment for individuals and organizations that are dedicated to achieving social change. By combining the unique features of an LLC with the ‘soul’ of a nonprofit, the L3C may result in dramatic increases in the availability of both private and philanthropic capital for ventures that are designed to further charitable and educational purposes.”); Thomas Kelley, *Law and Choice of Entity on The Social Enterprise Frontier*, 84 TUL. L. REV. 337, 371 (2009) (“Not long ago a man named Robert Lang appeared on the social enterprise scene promoting the Low Profit Limited Liability Company, or ‘L3C,’ as a new type of LLC specifically designed to accommodate the needs of hybrid social ventures.”).

food and housing issues . . . provide sustainable solutions to medical, sanitation, conservation, energy, and environmental issues.⁵⁶

Elsewhere the L3C has been touted as “A New Solution to New Problems,”⁵⁷ with the power, for example, to revitalize industries that are “suffering from increased global competition.”⁵⁸ Possible applications include “nonprofit structure for museums, concert halls, symphonies, recreational facilities and the hundreds of thousands of nonprofits that perform service for the government under contract, with the government as their primary source of revenue.”⁵⁹

The key to the L3C is its supposed superior connection to Program Related Investments.⁶⁰

⁵⁶ <http://www.americansforcommunitydevelopment.org/> (last visited Feb. 18, 2010) (ellipses in original).

⁵⁷ Nonprofit Law Blog, L3C - Developments & Resources, <http://www.nonprofitlawblog.com/home/2009/03/l3c-developments-resources.html> (last visited Feb. 18, 2010).

⁵⁸ *Id.*

⁵⁹ L3C <http://en.wikipedia.org/wiki/L3C> (last visited Feb. 18, 2010). It is appropriate to use this article as reflecting the views of L3C proponents, as the information closely tracks information directly advanced by known proponents, and the “Background” section of the Wikipedia article states, “Robert M. Lang, the creator of the L3C, CEO of The Mary Elizabeth & Gordon B. Mannweiler Foundation Inc. and CEO of L3C Advisors, L3C the nations very first L3C recommends that you visit the web page for Americans for Community Development for frequent developments on the L3C.” *Id.* (footnote, providing link to the webpage, omitted).

⁶⁰ The states that have enacted L3C legislation have apparently accepted this connection without hesitation. Legislative history on each enactment is scant, but the available information demonstrates that legislative sponsors have relied uncritically on information provided by L3C proponents and have portrayed L3Cs as having great upside potential and no downsides. For example, many of the relevant legislators’ remarks have focused on the L3C’s supposed PRI fast track.

“What we’re doing is opening up PRIs and the whole socially beneficial sector [The L3C] will become a vehicle for bringing in more money to socially beneficial entities without

Some of these legislators have simply repeated the sentiments of Americans for Community Development. *See, e.g.*, Michel Consejo, Vermont House of Representatives, <http://michelconsejo.web.officelive.com/beendone.aspx> (last visited Feb. 18, 2010) (“[P]rivate letter rulings are expensive and time-consuming, and as a result, few foundations make them. The purpose of the L3C is to bypass this process”); Illinois Senator Heather Steans, *Steans advances new socially responsible for-profit organizations*, (April 3, 2009), http://www.se-alliance.org/chicago_pk_steans.pdf (“Time and again I have seen companies pass up opportunities to invest in LLCs . . . due to an inability to establish a concrete tax exemption for the plausible investment endeavor.” Michigan Senator Jason Allen, *Senate passes Allen legislation to help charitable foundations* (Nov. 6, 2008) http://www.senate.michigan.gov/gop/readarticle_printable.asp?id=1828&District=37 (“Current IRS regulations make it difficult for private nonprofit entities, like charitable foundations, to participate in such ventures when they are structured as LLCs Our reform plan simplifies the system”).

One legislator went so far as to directly support Robert Lang’s proposition that the IRS will necessarily adopt the L3C model: “[T]here are enough states now that are pursuing this that it looks like the IRS will be able to adopt and sanction this without the need for the private letter rulings that they’ve had to give in these instances.” Kraig Powell, Utah House of Representatives, Remarks During Floor Debate Regarding S. Bill 148 (Mar. 10, 2009), *audio available at* <http://le.utah.gov/jsp/jdisplay/billaudio.jsp?sess=2009GS&bill=sb0148&Headers=true>.

Critical analysis of L3C legislation is almost wholly absent in the legislative records. The only suggestion for improvement of the L3C came from the Michigan Department of Labor & Economic Growth’s analysis of that state’s L3C bill: “[M]ore detail would be desirable. There is an entire statute devoted to nonprofit corporations. . . . At the very least, there should be a separate chapter of the act devoted to LC3s.” http://michigan.gov/documents/dleg/Analysis_of_Enrolled_L3C_Bills_261198_7.pdf (last visited Feb. 18, 2010).

compromising the return.”⁶¹ The L3C is “a new tool for social enterprise,” with the potential to “unleash more funding for for-profit companies with social missions.”⁶²

The potential is apparently enormous, because the L3C will allow the “tranching” of investments. At the lowest level or “tranch,” a foundation will make a low return, high risk investment in a “venture[] with modest financial prospects, but the possibility of major social impact.”⁶³ At the next level, the venture will draw investments from socially conscious investors, willing to take a below-market return for the sake of participating in a progressive form of free enterprise that will help make a better world. At the top level, the venture will be able to attract regular, profit-maximizing investors, whose participation at market rates is made possible by the subsidization of the lower two tranches.

“Because the foundations take the highest risk at little or no return, it essentially turns the venture capital model on its head and gives many social enterprises a low enough cost of capital that they are able to be self sustainable.”⁶⁴ Thus, the L3C has the potential to “leverage

⁶¹ Heather Peeler, *The L3C: A New Tool for Social Enterprise*,” 2 COMMUNITY WEALTH VANGUARD (August 2007), <http://www.communitywealth.com/Newsletter/August%202007/L3C.html> (last visited Feb. 18, 2010).

⁶² 2 COMMUNITY WEALTH VANGUARD, <http://www.communitywealth.com/Newsletter/August%202007/August%202007%20CW%20Vanguard.html#GettingReady> (last visited Feb. 18, 2010).

⁶³ Marc J. Lane, *L3Cs Hold Key To Solving State's Social Woes*, CRAIN'S CHICAGO BUS., available at <http://www.marjlane.com/index.php?src=news&refno=288&category=2008%20Lane%20Repos> (last visited Feb. 18, 2010). This investment will come from funds that foundation might otherwise distribute as a grant to a non-profit venture.

⁶⁴ What is the L3C?, <http://www.americansforcommunitydevelopment.org/supportingdownloads/BasicL3CExplanation-History.pdf> (last visited Feb. 18, 2010).

foundations' program-related investments to access trillions of dollars of market-driven capital.”⁶⁵

Unfortunately, this conceptual messiah is but a pretender; this emperor lacks clothes. L3Cs have no special ability to promote Program Related Investments, and the L3C construct is unnecessary, unwise, and inherently misleading. Current L3C legislation is so technically flawed that it undermines the very arrangements it seeks to promote. Moreover, the L3C “movement” owed much of its initial momentum to its claim that the Internal Revenue Code would be changed to give special preference to foundation investments in L3Cs.⁶⁶ That claim has now evaporated.

The L3C is Unnecessary

According to its proponents:

The central premise of an L3C's operation is its use of low-cost capital in high risk ventures and its ability to allocate risk and reward unevenly over a number of investors, thus ensuring some a very safe investment with market return. As is appropriate under the PRI structure, foundations could assume the top risk at very low return, making the rest of the investment far more secure.⁶⁷

⁶⁵ Marc J. Lane, *L3Cs Hold Key To Solving State's Social Woes*, CRAIN'S CHICAGO BUS., available at <http://www.marclane.com/index.php?src=news&refno=288&category=2008%20Lane%20Reports> (last visited Feb. 18, 2010).

⁶⁶ In some contexts, L3C proponents have acknowledged as much. Robert M. Lang, Response to Questions Posed in NASCO's Letter Dated March 19, 2009, Response to Question 6 (Apr. 10, 2009) (“The L3C concept, if existing solely in state law, will do little to reduce the current transactional costs associated with a foundation making a PRI investment.”). <http://americansforcommunitydevelopment.org/downloads/NASCO.pdf> (last visited, Feb. 18, 2010).

⁶⁷ Americans for Community Development, <http://www.americansforcommunitydevelopment.org/about.html> (last visited Feb. 18, 2010).

In fact, this type of complex arrangement is possible under every state’s regular LLC statute. Flexibility of structure is the hallmark of the limited liability company, as L3C proponents indeed acknowledge: “The L3C was built on the llc [sic] structure in order to provide the flexibility of membership and organization needed to cover a wide variety of social enterprise situations.”⁶⁸

L3C legislation adds nothing by permitting a limited liability company to have a “low profit” purpose. Many LLC statutes no longer require a for-profit purpose,⁶⁹ and for those that do, “low profit” certainly qualifies. Nothing in any LLC statute requires a limited liability company to seek the highest possible profit margin. Moreover, by hypothesis, many L3Cs will in fact be seeking high yield returns for at least some of their members.

An ordinary LLC can certainly be structured to receive and make use of foundation PRIs. Indeed, the private letter ruling most often mentioned in connection with L3Cs involved an ordinary limited liability company.⁷⁰

In sum, from the perspective of state entity law, there is nothing an L3C can do that cannot already be done through an ordinary LLC.

⁶⁸ What is the L3C?,

<http://www.americansforcommunitydevelopment.org/supportingdownloads/BasicL3CExplanation-History.pdf> (last visited Feb. 18, 2010).

⁶⁹ *E.g.*, Re-ULLCA § 104(b) (“A limited liability company may have any lawful purpose, regardless of whether for profit.”). *See also id.* § 104(b) cmt. (“Although some LLC statutes continue to require a business purpose, this Act follows the current trend and takes a more expansive approach.”). In addition, some states have expressly provided for LLCs with non-profits purposes. *E.g.*, Minn. Stat. § 322B.975, Ky Rev. Stat. Ann. §§ 275.015(18); 275.520-275.540. For a discussion of the Kentucky provisions, see Thomas E. Rutledge, *The 2007 Amendments to the Kentucky Business Entity Statutes*, 97 KY. L. J. 229, 249–250 (2008–09).

⁷⁰ PLR 200610020, 2006 WL 575197, discussed *infra* at nn. ____.

The L3C “Brand” is Unwise

The proponents of the L3C claim that:

The L3C makes it very easy for lawyers and laymen alike to grasp since it does not create a new structure but merely amends the definition section of the llc [sic] acts in most states....Probably more importantly than anything else, the L3C is a brand which stands for all this and more and hopefully as a brand will make the concepts easy to grasp and thereby frequently used.⁷¹

As explained above,⁷² the L3C’s principal selling point is its supposed ability to attract Program Related Investments, and the L3C is described as specifically designed “to dovetail with the federal IRS regulations relevant to Program Related Investments (PRIs) by foundations.”⁷³ But PRI ventures are anything but “easy to grasp.” The regulations are complex, and L3C legislation does nothing to remove that complexity.⁷⁴ In addition, investments by charitable

⁷¹ What is the L3C?,

<http://www.americansforcommunitydevelopment.org/supportingdownloads/BasicL3CExplanation-History.pdf> (last visited Feb. 18, 2010).

⁷² *Supra* Part I.

⁷³ Americans for Community Development,

<http://www.americansforcommunitydevelopment.org/about.html> (emphasis added) (last visited Feb. 18, 2010). *But see, e.g.*, Joint Study Committee on a North Carolina Applied Furniture Technology Center, <http://www.ncga.state.nc.us/documentsites/legislativepublications/Study%20Reports%20to%20the%202007%20NCGA/NC%20Applied%20Furniture%20Technology%20Center.pdf>, at 1 (stating that “[t]he Committee heard a presentation on low-profit limited liability companies (L3Cs). ... [which] have been proposed as a means for encouraging investment in struggling business enterprises” but noting that “[t]he Committee was concerned about ensuring that investment in a L3C by a non-profit would qualify as a program-related investment so that the non-profit would not run afoul of IRS regulations.”), (last visited Feb. 8, 2010).

⁷⁴ *See supra* Part III (explaining the nature of the determination and showing how designating an entity as “low profit” does not reduce the complexity or fact-specific nature of each

foundations into profit-making ventures raise a host of complicated non-tax issues, including potential conflicts of fiduciary duty for the foundation trustees, securities law concerns, “exit rights” for the foundation, etc. In these circumstances, a “brand” is simplistic and dangerous.⁷⁵

A few examples will suffice to illustrate the great complexity. Consider first the amount of control that each foundation must retain over any L3C enterprise into which the foundation invests. As explained in Part III, making sure that a foundation’s investment qualifies as a PRI requires a very fact-intensive analysis of the purposes of the foundation, the purposes of the investment vehicle, and the foundation’s ability to control the investment vehicle.⁷⁶

The foundation must at least assure itself that it can prevent the L3C from deviating from the “program related” purposes that brought the foundation into the enterprise in the first place. Such protection is certainly possible, but there are numerous ways to structure the protection. Each possible variation has implications for the foundation and for each of the other investors in the L3C. Finding the proper “deal point” takes sophisticated analysis—business as much as legal—and requires careful, tailored drafting of the L3C’s operating agreement. Inevitably, thoughtful negotiation is also required. There is nothing “off the shelf” about this type of

determination); *infra* Part I (explaining how L3C proponents initially claimed that the IRC would be amended to “green light” foundation investments into L3Cs).

⁷⁵ The issues discussed in the following text apply equally to an ordinary limited liability company used as a vehicle to receive PRIs. The point is not that such issues are “deal breakers” or otherwise pose insurmountable difficulties. Rather, the point is that the idea of an L3C “brand”—i.e., a simple, off the shelf mechanism—is unwise and inherently misleading.

⁷⁶ *Supra* Part III. As will be demonstrated *infra* Part IV, the L3C will do nothing to facilitate the PRI determination or to simplify the process of PRI analysis.

endeavor, and the supposed L3C “template” does nothing to facilitate the analysis, the negotiation, or the drafting.⁷⁷

Consider next the possible conflicts of interests for those managing a foundation that has made an important PRI into an operating business. The managers of the foundation have a duty to the foundation to maintain some oversight of the business.⁷⁸ The L3C’s operating agreement will therefore have to provide for that oversight, and it is likely that some representative of the foundation will have some governance or other, comparable role in the business.⁷⁹

Suppose, however, that at some point the interests of the foundation and those of the “top tranche” investors substantially diverge. Assume, for example, that: (i) a foundation makes a PRI into a business that operates a factory in an economically depressed area; (ii) the business develops intellectual property that is so valuable that a foreign corporation wishes to acquire the

⁷⁷ Brian Burnham Jones, L3C: Will the IRS favor Social Progress?, <http://www.triplepundit.com/2009/04/l3c-will-the-irs-favor-social-progress/> (stating that “[t]he L3C templates a deal, brands it and makes it easier to construct”) (a comment attributed to Robert Lang, posted in response to a web story, L3C: Will the IRS favor Social Progress?, posted Apr. 6, 2009) (last visited Feb. 8, 2010).

⁷⁸ Even proponents of the L3C accept this point. See e.g. Thomas Kelley, *Law and Choice of Entity on the Social Enterprise Frontier*, 84 TUL. L. REV. 337, 370 (2009) (“Where a social enterprise is dedicated to social outcomes but requires participation by for-profit capital investment, the two can easily be brought together under the roof of a single LLC because the membership agreement can reward the for-profit investors with a large share of any profits, while the social benefit nonprofit actors can retain ultimate decision-making power and thereby ensure that the firm remains committed to its social and/or environmental purpose.”).

⁷⁹ The foundation might obtain sufficient control by imposing lender-like positive and negative covenants, including veto power over specified categories of decisions. See e.g., Del Code Ann., tit. 6 § 18-101(7) (“A limited liability company agreement may provide rights to any person, including a person who is not a party to the limited liability company agreement, to the extent set forth therein.”) and Re-ULLCA § 112(a) (“An operating agreement may specify that its amendment requires the approval of a person that is not a party to the operating agreement or the satisfaction of a condition. An amendment is ineffective if its adoption does not include the required approval or satisfy the specified condition.”) Of course, this approach would require very careful analysis, negotiation, and drafting.

business in order to acquire the intellectual property; (iii) the foreign corporation is willing to continue operating the factory for three more years, but no longer; (iv) the takeover will be highly profitable for the top tranche investors, and they naturally enough want the deal to go through; and (v) the middle tranche investors may be conflicted, since by hypothesis they have invested in part to make money and in part to “do good.” Assume further that the takeover cannot occur without the consent of the foundation’s representative. The foundation presumably does not want the factory to close and would prefer to use the value of the intellectual property to continue to subsidize the important social enterprise (i.e., the factory and the jobs it provides).

If the L3C’s operating agreement does not very carefully address this situation, the foundation’s representative may be hopelessly conflicted – caught among duties to the entity, loyalty to the foundation’s goals, and duties to the top tranche investors. Those who manage a limited liability company have fiduciary duties not only to the entity⁸⁰ but also, in some circumstances, directly to the members.⁸¹ Moreover, since the foundation’s representative will

⁸⁰ Bishop & Kleinberger, *Limited Liability Companies*, ¶ 10.01.

⁸¹ Daniel S. Kleinberger, “Direct Versus Derivative and the Law of Limited Liability Companies,” 58 BAYLOR L. REV. 63, 90 (2006) (stating that “[c]laims that management has sold out too cheaply in a merger are . . . examples of direct claims”). It is possible to re-shape the fiduciary duties owed by an LLC’s manager, and under Delaware law it is even possible to eliminate fiduciary duty. Del Code Ann., tit. 6 § 18-1101(c) (“To the extent that, at law or in equity, a member or manager or other person has duties (including fiduciary duties) to a limited liability company or to another member or manager or to another person that is a party to or is otherwise bound by a limited liability company agreement, the member’s or manager’s or other person’s duties may be expanded or restricted or eliminated by provisions in the limited liability company agreement . . .”). However, the re-shaping or elimination must be done very carefully, lest unintended consequences result. Daniel S. Kleinberger, *Careful What You Wish For—Freedom of Contract and the Necessity of Careful Scrivening*, 24 PUBOGRAM 19 (October 2006) (Committee on Partnerships and Unincorporated Business Organizations of the ABA Business Law Section). See generally Bishop & Kleinberger, *Limited Liability Companies* ¶ 14.05[4][a].

be serving, in essence, as a deputy of the foundation, any breach of duty by the representative will likely inculcate the foundation.⁸² (In Illinois, in particular, representatives of all cooperating organizations may be conflicted.⁸³)

⁸² Restatement (Third) of Agency, § 7.04(1) (stating that “[a] principal is subject to liability to a third party harmed by an agent’s conduct when the agent’s conduct is within the scope of the agent’s actual authority or ratified by the principal; and the agent’s conduct is tortious “). *See also* Sinclair Oil Corp. v. Levien, 280 A.2d 717, 719 (Del. 1971). (“Sinclair nominates all members of Sinven’s board of directors. The Chancellor found as a fact that the directors were not independent of Sinclair. Almost without exception, they were officers, directors, or employees of corporations in the Sinclair complex. By reason of Sinclair’s domination, it is clear that Sinclair owed Sinven a fiduciary duty.”) Moreover, the foundation will likely have to defend and indemnify its representative. *See e.g.* Minn. Stat. § 317A.521 subd. 1 (c)(iii), subd. 2 (providing for a non-profit corporation to defend and indemnify a person acting in the person’s “official capacity” and defining that term to mean “with respect to a director, officer, or employee of the corporation who, while a director, officer, or employee of the corporation, is or was serving at the request of the corporation or whose duties in that position involve or involved service as a director, officer, partner, trustee, employee, or agent of another organization or employee benefit plan, the position of that person as a director, officer, partner, trustee, employee, or agent, as the case may be, of the other organization or employee benefit plan”). *See also* Model Nonprofit Corporation Act §§ 8.51(a), 8.52, 8.56 (3d ed. 2008). Comparable problems can arise if the foundation has used a lender-like approach, as described, *supra*, note 76. The combination of control and the foundation’s equity position invite a re-characterization of the control as a governance role carrying fiduciary duties. *In re Kids Creek Partners, L.P.*, 200 B.R. 996, 1016 (Bkrcty. N.D.Ill. 1996) (explaining that “[c]ourts reason that a lender usurping the power of the debtor’s directors and officers to make business decisions must also undertake the fiduciary obligation that the officers and directors owe the corporation and its creditors”); *In re Villa West Associates*, 146 F.3d 798, 806-807 (10th Cir. 1998) (rejecting a claim that limited partners owed fiduciary duties in the case *sub judice*, but noting that, under Kansas law, whether there exists a “fiduciary relationship between parties does not depend upon some technical relation created by, or defined in, law [but rather whether] there has been a special confidence reposed in one who, in equity and good conscience, is bound to act in good faith and with due regard for the interests of the one reposing the confidence”) (quoting *Gillespie v. Seymour*, 14 Kan.App.2d 563, 796 P.2d 1060 (1990), *rev’d in part on other grounds*, 250 Kan. 123, 823 P.2d 782 (1991)). The *Villa West* court noted further: “Fiduciary relationships recognized and enforceable in equity do not depend upon nomenclature; nor are they necessarily the product of any particular legal relationship. [Citations omitted.] They may arise out of conduct of the parties evidencing an agreement to engage in a joint enterprise for the mutual benefit of the parties. [Citations omitted.] But they necessarily spring from an attitude of trust and confidence and are based upon some form of agreement, either expressed or implied, from

Further complexity exists due to federal and state law regulating securities. It is now generally acknowledged that the “investment contract” analysis applies to determine whether a membership interest in an LLC is a security.⁸⁴ The determination is highly significant, carrying high risk, because both federal and state statutes impose significant registration and disclosure requirements on ventures that “issue” securities (even those whose securities are not publicly traded). The “investment contract” analysis is complex, but essentially turns on whether a person is investing in a common enterprise with the expectation of profits to be made chiefly through the efforts of others. That question in turn depends largely on the extent to which investors have a right (and, in some circumstances, the practical ability) to manage the enterprise. Day-to-day control is not necessary to avoid securities status, but certainly manager-managed LLCs are more likely to involve securities than are member-managed LLCs.⁸⁵

which it can be said the minds have met in a manner to create mutual obligations. [Citations omitted.]” *Id.* (citations omitted in the original). *See also* *In re Auto Specialties Mfg. Co.* 153 B.R. 457, 479 (Bkrcty.W.D.Mich. 1993) (noting that “where excessive lender control or influence can be established, the lender may be placed in a fiduciary capacity”).

⁸³ Illinois’s L3C statute defines any “chief operating officer, director, or manager of [an L3C as] a “trustee” as defined in Section 3 of the [Illinois] Charitable Trust Act.” 805 ILL. COMP. STAT. 180/1-26(d). In Illinois, a charitable trustee has the duties to “avoid . . . conflicts of interest” and “[t]o adhere and conform the charitable organization to its charitable purpose.” 760 ILL. COMP. STAT. 55/15(a)(1) and (4). According to the statutes, then, in an Illinois L3C *all* managers, whether representing a foundation or a for-profit organization, must uphold the charitable purpose of the venture.

⁸⁴ For a detailed explanation of this area of law, see Bishop & Kleinberger, *Limited Liability Companies*, chapter 11. Some states apply an additional test for making the security *vel non* determination. *See id.* ¶ 11.03A (describing the “risk capital” test).

⁸⁵ Bishop and Kleinberger, *Limited Liability Companies*, ¶ 11.03.

For an L3C, the securities law determination will be especially complicated, because nominally, at least, the foundations will not be investing with any expectation of profit⁸⁶ and yet will need some fundamental control over the enterprise. Depending on how fundamental that control is, its existence could increase the likelihood that the other investors are purchasing a security from the L3C when they become members (co-owners) of the L3C. In any event, the securities determination will differ for each tranche of investors.

Consider also the question of “exit rights”—the right of an investor to have its interests bought out by either the other owners or the venture itself. The question of exit rights is fundamental in any investment made in a business whose interests are not publicly traded, and the question has manifold complexity.⁸⁷ The flip side issue is whether the venture can require that a particular owner exit the venture.⁸⁸

⁸⁶ As explained *supra* Part III, for an investment to qualify as a PRI, “[n]o significant purpose of the investment [can be] the production of income or the appreciation of property.” 26 C.F.R. § 53.4944-3(ii).

⁸⁷ See generally F. HODGE O’NEAL ET AL., O’NEAL AND THOMPSON’S CLOSE CORPORATIONS AND LLCs § 9:5 (3d ed. 2008) (describing various protection measures available to minority shareholders in a closely held corporation). See also *Horning v. Horning Const., LLC*, 12 Misc.3d 402, 412, 816 N.Y.S.2d 877, 884 (N.Y. Sup. 2006) (“One certainly can sympathize with petitioner’s plight. In 2001, he had a thriving corporation and wished to reduce his work schedule. Whether for estate and gift tax reasons, or otherwise, he brought in two trusted men and gave them each one third ownership of a new venture set up as a LLC. But he did this without prior or contemporaneous execution of an operating agreement giving him fair exit rights in the event of future disharmony.”); *Frontier Oil v. Holly Corp.*, No. Civ.A. 20502, 2005 WL 1039027, at * 31 (Del. Ch. Apr. 29, 2005) (stating, in the context of a failed merger agreement, “Frontier’s angst stems from the nature of an agreement that allowed multiple exit strategies.”); Daniel S. Kleinberger, *The Closely Held Business through the Entity-Aggregate Prism*, 40 WAKE FOREST L. REV. 827, 863–68 (2005) (discussing how exit rights are viewed differently depending on the type of legal entity involved).

⁸⁸ Depending on the structure of the venture, various terms describe the mechanisms employed to address this issue—e.g., call rights, expulsion, mandatory puts, etc.

As with the securities analysis, foundation involvement infuses additional complications. Take as an example the enterprise that was the subject of Private Letter Ruling 200610020, sought by a foundation proposing to make a Program Related Investment in an Investment Fund.⁸⁹ The ruling outlines both the purposes of the foundation and the purposes and overall structure of the enterprise that would receive the PRI:

The Foundation's charitable programs focus on helping individuals attain economic independence by advancing educational achievement and entrepreneurial success, with the ultimate goal of promoting a society of economically independent individuals and engaged citizens who contribute to the improvement of their communities. The Foundation develops and implements programming focused on promoting education and entrepreneurship and is particularly committed to programs that advance both goals, as is the case with the current proposal.

The Foundation proposes to acquire a membership interest in the A (the "Fund"), which will be organized for the purpose of investing in businesses in low-income communities owned or controlled by members of a minority or other disadvantaged group that have not been able to obtain conventional financing on reasonable terms, and that will provide community benefits. *In addition to the Foundation, the other Members of the Fund will be current or former professional athletes on, or owners, coaches or managers of a professional sports team located in the greater B metropolitan area, or athletes, owners, coaches or managers from other professional sports teams who currently reside in the greater B metropolitan area.* Members may invest in their individual capacities, through a permitted assignee, or through an entity they control. . . . The proposal requires that the Members who are individuals (or, in the case of a Member that is an entity [controlled by an individual] . . . an individual who controls the entity) participate in an educational program regarding angel investing and entrepreneurship that will be developed and provided by the Foundation to the Individual Members.⁹⁰

⁸⁹ The Americans for Community Development website cites this private letter ruling as an example of how PRIs can fuel socially beneficial investment. Americans for Community Development, *The L3C: A For-Profit with a Non-Profit Soul*, http://americansforcommunitydevelopment.org/downloads/low-profit_limited_liability_companies_l3c_10.06.09.pdf (last visited Feb. 18, 2010).

⁹⁰ I.R.S. Priv. Ltr. Rul. 200610020 (Mar. 10, 2006) (emphasis added).

Now consider the “exit” issues that might arise if one of the individual members were a high profile athlete whose conduct gave rise to unpleasant notoriety—e.g., dog fighting, or shooting oneself in the leg while at an expensive nightclub.⁹¹ If the enterprise’s operating agreement is properly tailored, the enterprise will have the right to expel the miscreant from the venture, limiting any negative publicity and attendant problems (including problems for the foundation’s reputation). In turn, and again assuming that the enterprise’s operating agreement is properly tailored, the foundation will have sufficient power to cause the enterprise to exercise the enterprise’s right to expel.⁹²

However, it is no easy task to anticipate such problems at the outset of a venture, nor to foresee the multitude of other situations in which dissociation would be appropriate or even necessary to protect the foundation’s interests. Even when problems are appropriately anticipated, devising solutions acceptable to all parties is difficult. The task requires the ability to balance often countervailing interests and to design workable

⁹¹ See Lynn Zinser, *Vick Pleads Guilty to Dogfighting Charge*, N.Y. TIMES, Nov. 25, 2008, <http://www.nytimes.com/2008/11/26/sports/football/26vick.html>; John Eligon, *Burress Will Receive 2-Year Prison Sentence*, N.Y. TIMES, Aug. 20, 2009, <http://www.nytimes.com/2009/08/21/nyregion/21burress.html>; see generally JEFF BENEDICT, *OUT OF BOUNDS: INSIDE THE NBA’S CULTURE OF RAPE, VIOLENCE, AND CRIME* (2004) (noting the large numbers of National Basketball Association players who have been charged with felonies).

⁹² As alternative or additional protection, the foundation might insist that it have the right to withdraw upon the happening of specified events. Again, conceptualizing, delineating, and obtaining agreement to this approach would require careful thought, negotiation, and drafting.

mechanisms to effect that balance. The task is one of the most sophisticated in all of transactional lawyering and is far from “easy to grasp.”⁹³

The L3C Construct is Inherently Misleading

As just explained, the assertion that a PRI can be simple is flatly wrong and substantially misleading. Moreover, there has been considerable misinformation about the relationship between the L3C device and the tax law relating to PRIs.

Until very recently, state L3C legislation has been premised on the notion that the Internal Revenue Code would be amended to treat foundation investments into low profit limited liability companies as automatically PRIs.⁹⁴ The website for Americans for Community Development still states that:

⁹³ What is the L3C?, <http://www.americansforcommunitydevelopment.org/supportingdownloads/BasicL3CExplanation-History.pdf> (last visited Feb. 18, 2010). “Perhaps the reason many private foundations approach some PRI transactions with caution is that they realize arrangements between charitable entities and for-profit entities can be very complex, and intentionally investing assets in their portfolio into transactions expected to produce below-market returns is inherently risky. The reason many private foundations seek private letter rulings may be because they understand that PRI transactions which push the envelope in terms of producing income or the appreciation of property should be approached with caution.” Spenard, *Panacea or Problem*, at 133.

⁹⁴ letter of March 19, 2009, from Chris Cash, NASCO President, to Senators Max Baucus and Charles Grassley (chair and ranking member of the Senate Finance Committee), available at <http://data.opi.mt.gov/legbills/2009/Minutes/Senate/Exhibits/jus65b04.pdf>, last visited March 5, 21010. (“[P]roponents of the low-profit limited liability company (commonly referred to as an ‘L3C’) reportedly have made the case in state legislatures that these changes on the federal level are imminent and therefore the states need to get on board and create this L3C entity. Proponents have distributed a draft bill titled, “Program Related Investment Promotion Act of 2008,” and have said that the Senate Finance Committee approves of the concept and is working on the legislation. We’re concerned that these assertions may lack a basis in fact, yet have proven quite effective in persuading state legislators to pass these bills into law without giving them the close scrutiny they deserve.”).

[W]e have introduced The Program-Related Promotion Act of 2009, a version of which was discussed with Senate Finance Committee staff on Dec. 18, 2008 and with the Joint Committee on Taxation staff on Jan. 15, 2009. The objective of the proposed legislation is to facilitate PRIs by private foundations, in part by amending section 4944(c) of the Code to provide a process by which an entity seeking to receive PRIs can receive a determination that below-market foundation investments in such entity will qualify as PRIs.⁹⁵

An initial version of the proposed legislation provided for “Safe Harbor Determinations” and a rebuttable presumption to “green light” foundation investments made into L3Cs:

The Secretary shall establish a procedure under which an entity seeking to receive program-related investments may petition the Secretary for a determination that below market rate investments by private foundations in such entity will be program-related investments meeting the requirements [for Program Related Investments.] Under this procedure, the Secretary shall rule on all requests within 90 days of submission. *Entities organized under state law, or the law of any federally-recognized tribe, as low-profit limited liability companies shall be entitled to a rebuttable presumption that below market rate investments by private foundations in such entities are program-related investments.*⁹⁶

The proponents’ reference to meeting with key Congressional staff suggested that the Program-Related Promotion Act of 2009 was under serious consideration. However, the facts were quite to the contrary. On March 11, 2009, Paul Streckfus, Editor of the influential EO Tax Journal, sent “Email Update 2009-34,” captioned “Chuck Grassley: More Legislation, More Oversight Needed for Charities.” The update quoted Senator Chuck Grassley, R-Iowa, Ranking

⁹⁵ What is the L3C?,

<http://www.americansforcommunitydevelopment.org/supportingdownloads/BasicL3CExplanation-History.pdf> (last visited Feb. 18, 2010).

⁹⁶ PRI Promotion Act of 2008, Draft of 12/15/2008, 3:30 PM, § 2, amending IRC § 4944(c) (emphasis added) (copy on file with author).

Member of the Senate Finance Committee, at a session on charities and governance sponsored by Buchanan Ingersoll & Rooney, Washington, D.C.:

There is . . . a proposal to loosen private rules and regulations to allow them to more easily fund certain for-profit entities. There is very little information about these new entities, known as low-profit, limited liability companies, or L3Cs. Neither the Finance Committee nor the Ways and Means Committee has conducted any hearings about them. So I was a little surprised that the loosening of the tax rules for them was proposed as a stimulus initiative. It's too early for us to consider this proposal.⁹⁷

The “safe harbor” approach has no future. It would impose a substantial burden on the Treasury, and the concept of a deadline is novel, unjustified, and unworkable.⁹⁸ More fundamentally, the rebuttable presumption ignores the core of PRI analysis—i.e., the suitability of the investment vehicle, judged in terms of the particular purpose of the

⁹⁷ Copy on file with author. The information now appears on Senator Grassley's website, http://grassley.senate.gov/news/Article.cfm?customel_dataPageID_1502=19725, last visited, March 5, 2010. See also G. Ann Baker, *Did You Know?: Low-Profit Limited Liability Company Legislation*, 29 MICH. BUS. L.J. 5, 6 (2009) (quoting the Senate Finance Committee: “We are committed to strengthening charities and philanthropy. However, we have not had any hearings on this particular matter and do not think that it is ripe for federal legislation.”).

⁹⁸ Moreover, the safe harbor would impose substantial additional burdens on state charities regulators. “If we simplify the process through which we combine the charitable assets of private foundations with for-profit investment, we increase the risk that charitable assets will be utilized for subsidizing for-profit ventures. The framework that stands to move nonprofits and private foundations toward greater commercialization in their activities increases the risks that charitable assets will be looked to for the production of income or the appreciation of property rather than serving an exempt purpose. In the context of the L3C model, the benefit of eliminating the costs associated with private letter rulings for some PRI transactions may be outweighed by the increase in risk that charitable assets could be converted or diverted to a private use or otherwise wasted or mismanaged.” Spenard, *Panacea or Problem*, at 134.

investing foundation and the particular purpose and structure of the investment vehicle.⁹⁹

Consider, for example, a foundation whose charter limits it to promoting education among underprivileged children. Suppose further that this foundation were to make an investment in an L3C formed to own and operate a furniture factory. In what sense would the foundation's investment pertain to "the accomplishment of the foundation's exempt activities?"¹⁰⁰ Many other examples are available, because any legislation that privileges L3C status generally would have to ignore the core tenet of PRI law.¹⁰¹

L3C proponents now assert that L3C "legislation was specifically written to *dovetail* with the federal IRS regulations relevant to Program Related Investments (PRIs) by foundations."¹⁰²

⁹⁹ As one individual experienced with state charities regulation has stated, "[T]o the extent that the intent of the L3C model appears to simplify those transactions and make them more common by eliminating requests for private letter rulings, it causes concern among some state regulators because it begs the question of whether we are encouraging private foundations to leap before they look. . . . The nature of PRIs is complex, and if we eliminate a step in due diligence in order to eliminate a cost, we may get what we pay for, namely less due diligence." Spenard, *Panacea or Problem*, at 133–34.

¹⁰⁰ 26 C.F.R. § 53.4944-3(a)(2)(i) ("An investment shall be considered as made primarily to accomplish one or more of the purposes described in section 170(c)(2)(B) if it significantly furthers the accomplishment of the private foundation's exempt activities and if the investment would not have been made but for such relationship between the investment and the accomplishment of the foundation's exempt activities.").

¹⁰¹ There is some indication that L3C proponents understand this reality. The following statement appears as a comment to a web story, Brian Burnham Jones, *L3C: Will the IRS favor Social Progress?*, located on the website of *triplepundit*, posted April 6, 2009, <http://www.triplepundit.com/2009/04/l3c-will-the-irs-favor-social-progress/> (last visited Feb. 18, 2010). The statement is attributed to Robert Lang: "The IRS is never going to give a blanket ruling that L3Cs are OK because the law does not give them that latitude. Each deal must obey the laws for PRIs and stand on its own. . . . The L3C templates a deal, brands it and makes it easier to construct but it is not a warranty. Just because you buy a car that can safely go 150 miles per hour does not grant you the right to drive 150. I know because I created the L3C."

¹⁰² Americans for Community Development, <http://www.americansforcommunitydevelopment.org/about.html> (emphasis added) (last visited Feb. 18, 2010).

In fact, the enacted L3C legislation does nothing to help foundations seeking to assure themselves of PRI treatment.¹⁰³

Current L3C Legislation is Nonsensical and Useless

The tax regulations concerning PRIs require that “[n]o significant purpose of the [foundation’s] investment is the production of income or the appreciation of property.”¹⁰⁴ But the presupposition is that the private sector will also invest, seeking a profit. Indeed, the proponents of the L3C device highlight this presupposition: “The central premise of an L3C’s operation is its use of low-cost capital in high risk ventures and its ability to allocate risk and reward unevenly over a number of investors, thus ensuring some a very safe investment with market return.”¹⁰⁵

Despite this presupposition, the L3C statutes enacted to date do not authorize profit-seeking investment by anyone.¹⁰⁶ The typical L3C statute provides that: “no significant purpose of the company is the production of income or the appreciation of property.”¹⁰⁷ How is it possible to have a low profit limited liability company when no significant purpose of the

¹⁰³ Nor could it. See Treas. Reg. § 53.4944-1(a)(2)(i) (“Nor shall any State law exempt or relieve any person from any obligation, duty, responsibility, or other standard of conduct provided in section 4944 [Taxes on investments which jeopardize charitable purpose] and the regulations thereunder.”).

¹⁰⁴ 26 C.F.R. § 53.4944-3(a)(ii) (emphasis added).

¹⁰⁵ Americans for Community Development, <http://www.americansforcommunitydevelopment.org/about.html> (last visited Feb. 18, 2010).

¹⁰⁶ Even if they did, certain other provisions might prevent potentially lucrative profit-making opportunities. See *supra* note 77.

¹⁰⁷ 805 ILL. COMP. STAT. 180/1-26 (emphasis added). See also MICH. COMP. LAWS § 450.4102(2)(m)(ii); UTAH CODE ANN. § 48-2c-412(1)(b)(iii); VT. STAT. ANN. tit. 11, § 3001(27)(B)(2); WYO. STAT. ANN. § 17-15-102(a)(ix)(B).

company is the production of income or the appreciation of property? Try explaining that contradiction to investors, especially investors who are simultaneously being told that “tranching investing with the PRI ... is particularly favorable to equity investment.”¹⁰⁸ Try doing a private placement memorandum (under securities law) to explain the conundrum.¹⁰⁹

The technical drafting error is easy to identify. The creators of the L3C concept paraphrased the federal tax regulations that define PRIs. However, the paraphrasing produced a nonfunctioning result. A PRI contemplates a mixed purpose venture, with the foundation’s investment being essentially not-for-profit but other investors actually seeking a profitable return. Therefore, except where for some reason an L3C is acting as an entirely non-profit entity, the success of the L3C presupposes that the company will be seeking to make a profit.

It would be sophistry to assert that profit making is categorically insignificant for low profit limited liability companies, especially as to L3Cs using tranching investment. A central premise for L3C proponents is that— by using PRIs and tranching investment – the L3C “will become a vehicle for bringing in more money to socially beneficial entities without compromising the return.”¹¹⁰

¹⁰⁸ Americans for Community Development, <http://www.americansforcommunitydevelopment.org/about.html> (last visited Feb. 18, 2010).

¹⁰⁹ L3C proponents seem to have missed this conceptual glitch. *E.g.*, Robert M. Lang, Response to Questions Posed in NASCO’s Letter Dated March 19, 2009, Response to Question 5 (Apr. 10, 2009) (“The L3C concept provides that the primary purpose of the organization must be charitable, with the production of income permitted to be a secondary purpose.”) (emphasis added), <http://americansforcommunitydevelopment.org/downloads/NASCO.pdf> (last visited, Feb. 18, 2010).

¹¹⁰ Heather Peeler, *The L3C: A New Tool for Social Enterprise*, 2 COMMUNITY WEALTH VANGUARD (August 2007) (emphasis added),

It might be possible to fix the statutory drafting problem, but doing so would just further expose the unnecessary nature of the L3C construct. As demonstrated above, a blanket “brand” does nothing to simplify, speed, or otherwise facilitate the PRI analysis and a L3C “template” does nothing to simplify, speed, or otherwise facilitate the complex arrangements required before an entity can make constructive use of Program Related Investments.

Part V – Conclusion

L3C legislation is no “friendly amendment” to a state LLC statute. Using foundation funds to offer market-rate returns to “tranching” investors is at best a complicated device, not appropriate for “branding” and simplistic appeals to social conscience. When a foundation contemplates making a program related investment, the matter requires careful, individualized, professional assessment, not reliance on a branded template.