THE L^{3}C, HISTORY, BASIC CONSTRUCT, AND LEGAL FRAMEWORK

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INTRODUCTION

Robert Lang gave a brief presentation on the low-profit limited liability company (L^{3}C) at the Vermont Law Review L^{3}C Symposium, held on February 18, 2010. Then, he and Elizabeth Carrott Minnigh answered questions from the audience. This Article is based on the questions and answers from that presentation. It provides both a history of the L^{3}C and an explanation.

Robert Lang:

I first conceived of the L^{3}C business organization form in 2005. That name has created some issues. It does not mean the L^{3}C cannot make a substantial profit or that the investors cannot make a substantial profit. The name comes from the basis for the 1969 law that authorized Program-Related Investments (PRIs). We conceive of our economic world as divided into two parts—for-profit and nonprofit. If an entity is nonprofit that means it spends more than it receives in revenue every year. In other words, it operates at a loss. In order to make up that loss, people have to put money into that entity knowing they will not get it back.

The types of entities that normally receive such largess are ones that perform some sort of socially-beneficial activity. We commonly refer to these organizations as nonprofits or charities. A long time ago, the government recognized that these organizations filled a vital place in the social fabric of the country. They performed services that government could not do because not every taxpayer was willing to shoulder the expense of the activity nor would for-profit investors invest in such an enterprise. These activities were deemed worthy enough, however, to receive a partial government subsidy in the form of a tax deduction for those who donated to them. These organizations are routinely given further government subsidy by virtue of being exempt from the payment of most taxes.

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What the U.S. Government recognized in 1969 was that some of the activities that normally fell within the bailiwick of the nonprofit sector generated more income than it cost to operate the entity. This income, however, was not sufficient to attract for-profit investors to provide the capital needed to carry out the enterprise. For example, a drug company might refuse to do the research needed to develop a cure for a rare disease because of the return on the investment. If a cure was discovered, the return would be far below what its shareholders would expect. In many cases, an enterprise itself might be very high risk, such as the start-up of a factory to hire and train recovering drug addicts in a depressed area. The founders are more interested in helping the area and the drug addicts than in making money. Because of the risk and the return, for-profit investors would not provide the capital needed to start the business. In both cases, the revenues from the enterprise will exceed actual costs and the business can be self-sustaining if they can receive the capital they need at a price they can afford.

Since 1969, nonprofit foundations have been required to distribute 5% or more of their previous year's assets in furtherance of their charitable purposes. This is generally done in the form of a grant. The PRI exception was also carved out in the 1969 law, and allows private foundations to invest all or part of this 5% in a for-profit business that performs a socially-beneficial activity.

Elizabeth Carrott Minnigh:

By way of background, a PRI is an investment that is exempt from excise taxes under the § 4944(c)[1] jeopardy investments rules. This exemption enables a private foundation to make an investment in a for-profit entity without incurring excise tax if: (i) a return on investment is not a significant purpose of the investment, and (ii) it will not jeopardize the carrying out of its exempt purposes. To qualify as a PRI, the investment must have a socially-beneficial purpose that is consistent with and furthers a private foundation's own charitable purpose. PRIs have traditionally included loans, loan guarantees, and now in increasing numbers, equity investments in charitable organizations or in commercial ventures for charitable purposes. If an investment qualifies as a PRI, it is not only exempt from the jeopardy investment rules, it will also be treated as a qualifying distribution under § 4942; it essentially takes the place of a grant.

1. *See* I.R.C. § 4944(c) (2006).

Robert Lang:

PRI was designed to provide capital to those enterprises that operated in the space between the nonprofit and the place where traditional for-profits existed. That space is the low-profit zone. In that space, the profit earned is insufficient to meet the risk/reward parameters of normal for-profit investors. It is that space for which I designed the L^{3}C.

I had to come up with a name and we wanted branding. I needed a name that could result in an abbreviation that could be put at the end of a business name like Inc., or LLC, or something like that. That is how I came up with the name low-profit limited liability company. Low profit is for that low-profit zone between 0% and 6%, and limited liability company because it was a variant form of a limited liability company. The result was "L^{3}C" to go at the end of a name, and it created a brand. A brand is important as a quick identifier that lets everyone know what the entity is. A nonprofit is a brand and L^{3}Cs needed that identification.

What does an L^{3}C do? I call the L^{3}C "the for-profit with the nonprofit soul." The L^{3}C is operating in a space where it is going to be paying its own way in this world, but it may not make a lot of money. How does it attract investors? That is where foundations come into play. Instead of giving a grant, a foundation can make an investment in a for-profit if that for-profit is performing a social good. The L^{3}C does not receive a subsidy in operation. The L^{3}C is created with a capital subsidy. By using the foundations to take the highest risk at the lowest return, we turn the venture capital model on its head. Instead of having a venture capitalist take the first risk but want a big percentage of the profit to take that risk, the foundation takes that risk at a very low return and the credit worthiness of the rest of the structure is significantly improved. This provides ideal opportunity for tranched investments.

For those for whom the term is not familiar, tranching refers to layering. Normally each tranche represents a class of members and each class has a different level of risk and receives different returns on their investment in addition to other rights and privileges of the class. The terms equity tranche for the highest or first risk tranche, mezzanine for the middle tranche, and senior for the most secure tranche are often used. However, the number of tranches (or classes of membership) can range from one to an unlimited number. Because the whole entity will operate in the low-profit zone, and it does not have to pay any tranche of investor a high return, the result can be a market rate of return for market-rate investors who are investing in the enterprise alongside the foundation.

To illustrate, I will use a simplified structure and assume that no market-oriented investor will, in most cases, invest with a return that is projected from zero to somewhere around 5 or 6%. If a socially-driven enterprise will only earn a 6% return, how do we get adequate capital into the enterprise? If a foundation invests 50% of the capital required and takes first risk position, but only asks for a 1% return, then the commercial investors can receive their 6% plus the 5% the foundation has given up for a total return of 11%. The possibilities are endless. The result is an enterprise that is low-profit overall, but produces significant returns to commercial investors.

This example, being simplified, does not take into account that an L^3C might frequently have at least three tranches commonly referred to as equity, mezzanine, and senior. In our example above, the foundation is the investor in the equity tranche and the market-rate investor is the investor in the senior tranche. It is our hope that in many L^3Cs investors willing to sacrifice a portion of the return in exchange for knowing that the L^3C is performing a socially-beneficial mission will populate a mezzanine tranche. In most LLCs, the mezzanine investor frequently asks for a return somewhere between what the senior investor requests and what the equity investor receives. We have identified this socially-motivated category of investor, and see them as a way to further reduce the total returns that need to be paid to investors.

Another advantage to the tranched structure unrelated to financing is that it allows the foundations that make the PRIs, for example, to have their own class or tranche. Then, that class is given certain powers in the operating agreement, usually in the form of either veto powers or voting rights that allow them to insure that the mission will not be lost or altered. Other classes might protect the rights of certain kinds of investors. Since various classes have different rights and requirements, the manager also has a clear map of obligations and responsibilities.

Elizabeth Carrott Minnigh:

I think the term "low-profit" in the name has misled many people into thinking that the Internal Revenue Code prohibits a private foundation from receiving a market rate of return on a PRI as a matter of course. In fact, the PRI regulations do not actually limit rates of return on PRIs. The IRS does require, however, that the purpose of the investment cannot be the production of income or appreciation of capital. Still, a return can be achieved as long as it is secondary to performing a socially-beneficial purpose. The regulations also require that the investment be made on terms

that a conventional, for-profit investor would not make. This means a PRI must carry with it risks sufficiently high that a traditional for-profit investor would not make the investment.

Generally, a private foundation gives away grant dollars—at least 5% a year—and there is no return on grant dollars. The PRI exception provides a little window for private foundations to benefit from the potential return on the qualified distributions they make each year. Sometimes these investments will pay off and result in the private foundation receiving a return. If a private foundation receives the investment back, this return on investments along with any profit would have to be invested in another PRI or grant within one year of receipt. In that instance, charitable dollars are increased. Where the private foundation receives nothing back on its PRI, that investment is essentially the same as a grant.

Robert Lang:

In 2006, I made the first public presentation of the L^3C at an Aspen Institute conference in Washington, D.C. At that conference, I met three individuals who became important members of the team. The first was Arthur Wood, who at the time was Social Finance Director of Ashoka. The second was John Tyler, the Secretary and General Counsel of the Kauffman Foundation. The third was Marcus Owens of Caplin & Drysdale.

Arthur Wood had been doing a lot of work on the financing issues facing the social sector and was excited about the potential of the L^3C as a vehicle for tranched investment. From his perspective, a key to solving the long-term shortfall in funds for social projects was to find a way to tap for-profit investment funds. The L^3C was an answer. John Tyler had done extensive groundwork in the use of LLCs to perform socially-beneficial missions. The private letter rulings he helped to obtain and his other writings provided us with sound legal precedent for the L^3C. Marcus Owens, whom we retained as legal counsel, helped us shape the actual L^3C law, which was first proposed in the North Carolina Legislature in 2007. In January 2008, Representative Michele Kupersmith and Senator Susan Bartlett introduced it in the Vermont Legislature on our behalf. On April 30, 2008, with Governor Douglas's signature, Vermont became the first state in the country to adopt the L^3C.

When I first conceived of the L^3C, I had a more limited concept in mind than I have now. It was totally concentrated on finding a way to allow foundations to make investments into socially beneficial activities more efficiently and in partnership with commercial investment by creating a vehicle that would encourage foundations to do so. It has grown into more

than that, beginning with Arthur Wood, who expanded on the original tranched financing concepts, and Marcus Owens, who wrote the initial law for us, and figured out how to make the L^{3}C part of the LLC Act rather than having to create a whole new structure from the ground up.

The LLC is essentially a very simple construct. The organizing members[2] sit down and write an agreement stating how they want to organize the company, what the duties and responsibilities of each member will be, how it will be financed, and what it is going to do. This agreement is called the operating agreement. It is a contract. An L^{3}C is a variant form of LLC, so that agreement is whatever two people want to do, three people want to do, or one hundred people want to do. Because everything is defined in the operating agreement, the members can be of various types. It is easy for individuals, foundations, non-governmental organizations, corporations, and government agencies all to be members of the same L^{3}C. This structural flexibility is one of the elements that makes the L^{3}C far more than just a vehicle for PRIs. Since the L^{3}C law states clearly that the L^{3}C must perform a socially-beneficial activity, and must place that mission above profit, it serves the need for collaboration in this country. If we are talking about individuals, businesses, governments, or nonprofits, we are talking about players that cannot seem to talk to each other in one place. If these players are given a framework, they can each take a piece of paper, write down what they envision and how they want it to work, and put it together into an operating agreement. The result is a structure in which very disparate groups and individuals can operate.

Elizabeth Carrott Minnigh:

That operating agreement sets the terms of the relationships between the parties. However, unlike most traditional LLCs, the L^{3}C is designed to have nonprofits investors. With nonprofit investors comes a special set of concerns.

Nonprofits receive special tax status. They generally have no income tax, and to some extent no sales tax and no property tax. Because nonprofits operate in this special tax world, the IRS has imposed various rules on nonprofits that restrict their ability to compete with for-profits by operating their business or making investments the same way for-profits can without being taxed on their return. PRIs are a limited exception that allows private foundations to make an investment in an entity as long as it is furthering their purpose. The investment needs to significantly further one or more of

2. The owners of an LLC are called members rather than shareholders.

the exempt purposes of the foundation. It needs to match up with the foundation's purposes.

The fact that it has a charitable, educational, scientific, or literary purpose is not enough—it has to actually dovetail with the purposes of the foundation that is making the investment. What would be a valid PRI for one organization might not be a valid PRI for another organization. For example, if you are an environmental organization you cannot make a PRI investment into a for-profit that is doing medical research unless it has some tie to the environment. You have to be investing in the environmental arena.

Additionally, the purpose of the PRI cannot be the production of income or the appreciation of capital. That is the low-profit concept—the idea that they exist for the social purpose and not for a return on investment. Finally, the purpose of the PRI cannot be to further political and legislative goals. This is consistent with the restrictions on charitable organizations in general. All of these core restrictions should be expressly addressed in the operating agreement. These prohibitions are part of the L^3C law, but they should also be written clearly into the contract between the parties. It is important that all the parties understand these restrictions.

The operating agreement needs to address more than just the purpose restrictions and issues like providing reports to investors so that the private foundation can exercise expenditure responsibility. The state statutes authorizing the L^3C are just the start of the discussion. It is really the operating agreement that does the heavy lifting. Getting the right operating agreement in place is necessary to the success of any L^3C.

Robert Lang:

The question of how many successful L^3Cs have been created comes up frequently. For some reason, many people believe that passing a law creates instant change, but that is not the case. First, the culture must change, adapt, and become familiar. All things take a while to evolve. Second, we did not plan when we got Vermont to pass the bill that it would be timed with the collapse of the economic system. Vermont passed the L^3C legislation in April 2008, and the in fall of 2008 the economic world collapsed. So, foundations that in August 2008 were saying, "Yes, start talking to us about this. We are interested," turned around in November and said, "We do not have any money. We cannot meet our existing commitments. We cannot meet next year's commitments. Do not talk to us for awhile."

Real and imaginary issues with the IRS are also part of the equation. Since 1969, there has never been a requirement in the law or the code, etc., that foundations had to get prior approval from the IRS to make PRIs. The code contains some very clear examples of what makes a PRI. The enforcement provision is that if a foundation makes a PRI, they report it on their 990PF. It is an obscure reporting; it is not really something that is obvious. If the IRS happens to actually select that 990 for reading—which is a big if—if they go back that far in reading it, and if do not like what they see in the description of the PRI investment, they might ask some more questions. If they are still not happy, they might actually do a real audit on the issue. Very little has ever happened in that field. Marc Owens, who wrote our original law, was head of the exempt division of the IRS for ten years. He has sat at lunch and made the comment to me, "We never saw a problem with PRIs the entire time that I was at the IRS. We never saw that as an enforcement issue."

In fact, the IRS probably does not know much of anything about most of the PRIs that are out there. The state regulators know even less because there is no reporting function to flag them. The IRS does not go through the forms, pick out and itemize PRIs, and somewhere publish a list of them. Then we came along and said, "Now we are going to make it easier. We are going to make it more transparent because we are going to put a designation at the end so people will be able to understand an L^3C and hence the purpose of the PRI."

All of a sudden the establishment started saying, "Oh, this is terrible. You cannot do this without private letter rulings." As Arthur Wood pointed out, in the time that one foundation got one private letter ruling, 100 L^3Cs were formed. In the fall of 2008, we realized that the answer to moving the establishment players required a three-pronged approach. One was to create as many L^3Cs as possible and get foundation funding from those foundations that were more forward thinking in order to demonstrate that the concept worked. Another was to push the bill through additional state legislatures to show it was a movement, and not just a Vermont anomaly. The third was to create a federal bill that would simplify the approval process at the IRS level. The proposed legislation has undergone several changes but is deceptively simple.

<u>Elizabeth Carrott Minnigh</u>:

One of the big issues that people have with PRIs is that, like many things in the Internal Revenue Code, whether something qualifies as a PRI is a facts and circumstances test. So the IRS must look individually at each

PRI that it reviews, and it only really comes under review if someone makes a private letter ruling request or the PRI gets picked for a review of the foundation's 990PF. As far as we know, the IRS does not compile data on how these are done and, until recently, PRIs were not discussed very widely in the foundation community. Because PRIs are relatively unknown and subject to a facts and circumstances test, with real penalties if the foundation guesses wrong, a lot of foundations and their advisors are nervous about undertaking a PRI. The L^3C is an attempt to give a road map. The federal legislation, while not necessary to the use of L^3Cs, or PRIs in general, is an attempt to further address that nervousness by providing even more of a road map and giving the foundations a chance to get a blessing by the IRS on the investment in a shorter period of time with less cost.

We are asking Congress to do a couple of different things. One of them is to create a rebuttable presumption. That is probably the most controversial component. That is the component that seems to makes the IRS the most nervous and unhappy. I think it would make people a lot more comfortable if Congress were to adopt it. If people see the L^3C designation and know that it means there is a presumption that they are doing the right thing and that somebody is designated to oversee the L^3C, it would make people more comfortable.

I think the most important thing that the proposed legislation does is ask for there to be an information reporting requirement. The 990, or the 990PF in the case of foundations, is an information return. These reports provide necessary information to the public. The pubic has a right to this information because it is donating to the nonprofits and the organizations are receiving federal and state tax benefits. If similar reporting requirements are imposed on L^3Cs that receive "charitable" dollars, then the IRS, and the public, will be able to track where these "charitable" dollars are going in a way that is not currently possible. This separate return would ask for information like: what are the recipient(s) of PRIs doing with the investments; how are the recipient(s) of PRIs ensuring that the PRIs comply with the IRS rules; which foundations are making PRIs, and how often and for what purpose(s) are these investments being made.

That is what I find interesting about the little bit of opposition that has come up recently. They are saying that the L^3C designation is going to trick people into thinking that this is a done deal, and that they do not have any due diligence to do. However, the federal legislation would really be helping people do that diligence and providing an easier method of enforcement. Another criticism has been that PRIs can be made into traditional LLCs, which is true. However, the PRI legislation puts a state law restriction on the entity to comply with those federal PRI regulations or

risk losing their status as an L^3C. This raises the question of who will enforce these state restrictions. Where the L^3C has a foundation investor, they will really be the first line of defense in forcing the L^3C to comply. If the federal legislation is passed and a federal information return is required, most states would probably require copies of these federal returns to be filed with the state just the way they require nonprofits to file their return with the state, often with a one- or two-page additional form. I think if people have the information, and see that other people are doing it—and doing it correctly—and that the IRS is given the opportunity to review it, they will see that good things are happening and then a lot more people will want to do it. That is when the L^3C is really going to take off. So I think the federal legislation is a huge part of making those numbers grow. It is going to grow regardless, whether it is the L^3C as currently in place or something that the L^3C model morphs into, but it will grow much more quickly if we get federal legislation and make people comfortable with the idea.

Robert Lang:

Interestingly, in order to form a nonprofit, all that is required is to fill out a form for the IRS, pay them a few hundred dollar fee, and if the form is properly filled out they will almost always grant nonprofit status. Filling out the form properly is really the only requirement. There may be a little negotiation, but if the intent is legal and genuine then approval is likely. The organization is really "promises to keep." If it keeps its promises, then the IRS will continue, year after year, not to question our nonprofit status. If it does not keep the promises, then the IRS is going to come after it. In truth, that is all the PRI is—promises to keep. The foundation says it is going to invest a specific amount of money for a specific purpose and basically the IRS looks at it after the fact, and says that the investment either did or did not comply.

The whole concept of prior approval and getting a private letter ruling probably came about because it was not a hard thing to get in 1969, and foundations tend to be very risk-adverse. Government was not the giant entity that it is today. Now private letter rulings have mushroomed into this process that takes eighteen months, costs $50,000 to $100,000 in legal fees and there is an $8,700 fee to the IRS just for a private letter ruling. Private letter rulings were never really meant for promises to keep. Private letter rulings were designed for events that exist. They do not work well on promises to keep because frankly, if you are starting a venture—and the IRS recognizes this with nonprofits—very few nonprofits do *exactly* what

they said they were going to do because it is just like any business. Once you start it, things can change.

Elizabeth Carrott Minnigh:

Favorable tax treatment and potential investment return should make PRIs attractive to larger private foundations. However, PRIs account for around 1% of the qualifying distributions made by all private foundations, despite being a strong tool to advance charitable purposes. Many in the nonprofit world hypothesize that the reason private foundations refrain from investing in for-profit ventures is because of the cost and time associated with obtaining a legal opinion from counsel or a private letter ruling from the IRS in order to verify that the particular venture is a valid PRI. Although a legal opinion or private letter ruling is not a prerequisite for making a PRI, it has commonly been treated as if it were.

Robert Lang:

One thing folks that are new to this field need to understand is that the concept of a PRI is really only relevant for private foundations. It is easy to get confused, but every 501(c)(3) organization is further divided into private foundations, or what are called public charities, even though that term does not exist in the Internal Revenue Code. Understand that PRIs arise out of the private foundation rules, though certainly a public charity could also participate in an L^3C. The introduction of the L^3C has shown that our legal structures are forty to fifty years behind the vision of social entrepreneurs. You will find from the state regulators, and even the attorneys that practice in the field, that there are going to be more negatives before there are positives because the structures we have just do not accommodate where social entrepreneurs are today. We encounter them all the time and they have great ideas but they just do not fit neatly into the structures that we have today. Someone had to start the conversation about how are we going to fill that middle space, and the L^3C is part of that conversation. We do not know if the L^3C is the total answer, but it is the discussion that has to happen.

It is an answer and sometimes we have to have an answer before we know the next question. We have talked about securitization and how an owner of a membership share in an L^3C would market their shares as securities. That raises a whole host of questions. But we have to have L^3Cs that are securitized before we can talk about trading them. We have to have

concrete situations before we can work with attorneys and investment advisors on how to handle them.

Elizabeth Carrott Minnigh:

With any new structure there are going to be kinks, there are going to be problems, there are going to be issues that arise, and it takes time to work them out. This was certainly true when the LLC format was first introduced. Until there are a large number of entities employing the L^3C model, you are not really going to know what kinks exist. When there are 100-some entities, it is hard to really have a sampling of what the problems are going to be. That is why you need a larger number of entities and more information about them. This is what the information return would do—it would allow people to gather information, determine if the model is being used correctly, and identify issues that need to be addressed. That is obviously what is happening in the nonprofit arena, where there are a number of abuses and issues. People are compiling and analyzing data, and then making decisions about whether there need to be changes. Perhaps not as quickly or as efficiently as we would like, or maybe not with as much guidance, but in that arena at least someone is doing it.

Robert Lang:

When LLCs first came in many objections were raised. Now the LLC is the most commonly used form of business organization in the country and nothing has ended because of LLCs. You have to put things in perspective. Sometimes you just have to do things and learn as you do them.

Another area often discussed is the process by which foundations evaluate potential PRIs and what metrics should they use. Unfortunately, foundations do not do grants simply either, which is an issue with me. I think that sometimes foundations get all involved in a whole process on the grant issue and, at the end of the day, a lot of the grant decisions are made because somebody knows somebody, or somebody likes somebody, or some idea intrigues somebody. So people fill out so much paper and the first page gets read and that is all that counts anyway. An argument that I have had with a lot of foundations is that they should not treat grants and PRIs differently because a lot of the foundations that now make PRIs talk about credit analysis. I ask, “Why are you talking about credit analysis?” and they say, “Well, we are going to make an investment.” I say, “Wait a minute, if you give them a grant it is like walking over to that window,

taking the money and throwing it out. You will never see it again. So, instead of throwing the money out the window you invest the money as a PRI and you may get a rate of return and you may get your investment back. Is that not better than throwing it out the window? So why do you care about the credit?"

I was in Missoula, Montana back in June 2009. I was sitting there at breakfast reading a newspaper and read an article about a drop-in center that had to close. Things close—but this was a branch of an organization that had three or four drop-in centers so presumably they should have known what they are doing. They opened the drop-in center in January and they are closing it in June. They never had enough money to really run it. They had enough money to open the door and they prayed to God that after they opened it somebody would say, "Well this is a wonderful thing" and come along and give money. No one with business sense would start a for-profit business like that. We know the rules of thumb. We have to have a couple of years' worth of money in the bank to keep it going so that even if it does not make a dime we can keep the doors open. "You build it and they will come" may work but that does not mean they are all going to come tomorrow morning, so we have to have some money to cover expenses, for marketing, etc.

A foundation, whether looking at a nonprofit or a for-profit, should look at what an organization has for a business model. How are they going to stay in business? How are they marketing themselves? How are they convincing people they have a service that they need? But once that hurdle is cleared, why put them through a different analysis for a grant or a PRI? The foundation should be looking the other way, saying, "This is a better chance because I might get some of this back." And by the way, we are talking venture capital here. Why do venture capitalists ask for very high rates of return? Are they greedy? No. Venture capitalists ask for high rates of return because they lose money on most of the ventures they invest in. So the couple that make it have to pay for all those other guys. So what the foundation is going to do, if it invests for mission impact, it is investing in a lot of L^3Cs that are not going to make it and the foundation is going to lose its investment. That is fine. Now they are a venture capitalist. That is what venture is all about. And a venture capitalist may make a lot of money on a few, but one of the things with this low-profit concept to consider is that the IRS said profit cannot be the primary purpose—it did not say it could not make money. There is a difference. For the foundation, however, when an L^3C starts making commercial level profits on a regular basis and cannot reinvest those profits to expand the mission, it should sell its shares and reinvest the principal in a new L^3C or make a grant.

Elizabeth Carrott Minnigh:

Like many attorneys, I am naturally risk-adverse. I just want to caution that there is a lot of due diligence that foundations have to do here because there is excise tax if you mess it up. You want to look at their business plan. You want to know what they are doing. Is it in line with your purpose? Have they added any other investors that have done that type of investment? What have they found? What level of risk is there? Which are going to be the for-profit ventures? How are the tranches organized? Are there two classes of investors? Are there three levels? What are the different rights of these classes? How are you going to be able to enforce those rights? How does the foundation get out if the investment turns out to be problematic? There is a lot of due diligence to be done. The board of a foundation considering a PRI needs to be careful and they need to review the materials. It is not just "jump in with both feet;" it should be more streamlined, and people should know what questions to ask.

Robert Lang:

These are the same questions you would be asking if you are making a grant. To whom are you making the grant? What are they going to do with your money? If they are spending 99% of their money raising money, then maybe it is not worth giving them a grant because maybe none of it is ever going to get to programs. These are questions you have to ask no matter what. I often hear questions about how organizations with dual missions—which must have a primary goal of performing a socially-beneficial purpose—balance these purposes, how the balancing is done, and what governance structures are being used to balance the socially-beneficial purpose and the profit-making. The questioners often wonder what practical structures are actually being used.

My answer is that there are probably no real rules or examples to follow, and to some extent, it fits in. In his concurrence in a mid-twentieth century free speech case, Supreme Court Justice Potter Stewart did not attempt to provide a firm definition for obscenity, but instead stated, "I know it when I see it."[3] I do not mean to minimize the questioners, but I think one can look at nonprofits and L^3Cs and have a real sense of whether they are putting mission first. The IRS uses this same concept in a lot of the tests. They look at the entity and how it is spending its money and can say, "I think they seem to be trying to do something good."

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3. Jacobellis v. State of Ohio, 378 U.S. 184, 197 (1964) (Stewart, J., concurring).

So these things happen. I think if you try to build in governance where you have rules, the minute you do this, this gets into complexities that are hard to understand. We might need some regulations regarding the mission–profit balance in an L^3C, but I would prefer to wait until we see what people do with them before we regulate them to death. The time might be right for some of us to suggest some voluntary guidelines, but we should not forget that one of the reasons for using a for-profit vehicle instead of a nonprofit is to encourage entrepreneurship instead of risk avoidance. Another reason is to give the organizers financial incentives to succeed with both mission and profit.

Elizabeth Carrott Minnigh:

Personally, I think that this is only going to work and this is only going to take off if most of them are done correctly. To be done correctly on a large scale, there must be some—for the lack of a better term—best practices. Those will take some time to sort out. But since L^3Cs cannot be driven by profit, there must be some other type of metric by which to measure the performance an L^3C and its managers. It is harder to measure social good. It may take awhile to sort out those best practices and it may not be as clear as it is in a traditional corporate environment, but I think it is really necessary to give some of these smaller L^3Cs—who do not have lawyers on retainer—some guidance on how to operate. I also think it will go a long way to making foundations more comfortable with the PRI if they can point to certain indicators of good governance when reviewing a potential recipient. However, I think that is going to be sorted out as some of these entities get up and running and we all start to figure out what makes them work.

Robert Lang:

Two of the problems that the L^3Cs are facing are misinformation and a lack of information. That is something that I have seen in talking with people everywhere. The question they have been asking me is: what, other than the federal legislation, is being done to spread the word not only to foundations, but also to businesses and nonprofits? A lot of early adopters are kind of islands right now and they are still figuring it out and no one else around them knows what is going on. My answer is that this is just a problem of being an early adopter in any field. The internet has created a problem today. It creates a lot of benefits and a lot of problems. Anybody with a computer can find a place to post information and there is no

clearinghouse to find out if the information is accurate. There are all sorts of L^{3}Cs out there, and frankly some of the people who formed L^{3}Cs should have asked somebody that knew about them before they formed them. We at Americans for Community Development have a website.[4] We have information on the L^{3}C.

The L^{3}C is still a new concept and people everywhere have a whole lot of ideas about how to organize and use them. Only time will tell what will happen. I end with only one word of caution—do not stifle them before they have a chance to blossom.

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4. *See* AMS. FOR CMTY. DEV., THE ORGANIZATION FOR THE L3C, http://americansforcommunitydevelopment.org/.