INTRODUCTION

On April 30, 2008, Vermont recognized a new business entity, the low-profit limited liability company, also known as the L3C. An L3C is a for-profit organization, designed to retain the flexibility of a limited liability company (LLC), but with a primary motivation to achieve a charitable goal. It is also expected to facilitate social investing from private foundations through program-related investments (PRIs), which are investments private foundations can make in social enterprises without jeopardizing their tax-exempt status. In the two-and-a-half years since Vermont adopted the L3C, six other states and two tribal nations have recognized this new social hybrid. During that time, 112 entrepreneurs also registered their L3Cs with Vermont’s Secretary of State.

This Article examines the experiences of the early adopters of the L3C business form. Through surveys, phone conversations, and examinations of web sites, I explored the reasons these social hybrid pioneers chose the L3C over alternatives such as a traditional LLC or a 501(c)(3) tax-exempt
organization. I found a group of entrepreneurs who embraced the unofficial slogan of the L3C, “the for-profit with a nonprofit soul.” The flexibility and simplicity of the L3C form also appealed to them. The possibility of attracting PRIs intrigued some, but certainly not all, of these entrepreneurs, and it was not the prime motivator for any of them. Given a choice between creating a traditional LLC or a 501(c)(3) tax-exempt organization, every entrepreneur I interviewed would choose the LLC.7

These findings suggest that the priorities of the entrepreneurs who adopted this business form were somewhat different from those who invented it. Nevertheless, the L3C gives voice to these entrepreneurs’ business values in a way that no other current business form does. These findings can inform policy decisions about the future of the L3C and provide substance to discussions about the L3C and other forms of social enterprise.8

Part I of this Article examines the legal and theoretical basis for the L3C. It describes the genesis of the idea, the typical statute, the strategy behind its adoption, and the criticisms that have been raised. Both the strategy behind the L3C and the critical response depend on assumptions about the behavior of social entrepreneurs that are worth testing.9 Part II introduces the study I undertook to test some of these assumptions. It sets forth the methodology of the study and describes the organizations that

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7. See infra notes 117–37 and accompanying text.


9. The strategy and response also depend on assumptions about the behavior of private foundations. Private foundations are not subjects of this study, except to the extent that the L3C pioneers discussed their interactions with foundations. In 2009, three students at the Tuck School of Business at Dartmouth College undertook a small study of foundations’ reactions to the L3C and found very little interest in the concept. Jason Bradfield, Moses Vejil & Will Vincent, The Low-Profit Limited Liability Company (L3C) (unpublished manuscript) (on file with Vermont Law Review).
responded to a letter asking L3C pioneers to participate in the study. Part III describes the experiences of the L3Cs that responded—why they chose this business form and their reactions once they began to use it—in order to begin to test the assumptions and make early observations. Part IV draws on those observations and suggests questions for further discussion among policy makers, academics, and social entrepreneurs.

I. THE LEGAL AND THEORETICAL FRAMEWORK FOR THE L3C

The impetus for the L3C stemmed from an observation that a little-used tool in the private foundation toolbox, the PRI, could be used to help capitalize social enterprises.10 A PRI is an investment made for the purpose of furthering a foundation’s exempt purpose. It can take the form of a loan, an equity position, a loan guarantee, or any other transaction in which the foundation has an economic interest, so long as it has the following characteristics: 1) its primary purpose is the accomplishment of a charitable purpose that is enumerated in I.R.C. § 170(c)(2)(B); 2) neither the production of income nor the appreciation of property is a significant purpose of the investment; and 3) it does not have any prohibited purpose such as lobbying or intervention in a political campaign.11

Section 170(c)(2)(B) defines the word “charitable” as being “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[.]”12 An organization will ordinarily satisfy this charitable

10. Robert Lang, the chief executive officer of the Mary Elizabeth & Gordon B. Mannweiler Foundation, Inc., presented his idea about the L3C at a meeting sponsored by the Aspen Institute’s Nonprofit Sector and Philanthropy Program in 2006, the contents of which are presented in THOMAS J. BILLITTERI, MIXING MISSION AND BUSINESS: DOES SOCIAL ENTERPRISE NEED A NEW LEGAL APPROACH? (2007), available at http://www.aspeninstitute.org/sites/default/files/content/docs/pubs/New_Legal_Forms_Report_FINAL.pdf. After that meeting, Lang teamed up with two of the other participants, Marcus Owens, a partner at Caplin & Drysdale and a former director of the IRS Exempt Organizations Division, and Arthur Wood, then Director of Social Financial Services at Ashoka, to develop the idea further. Sue Woodrow & Steve Davis, The L3C: A New Business Model for Socially Responsible Investing, COMMUNITY DIVIDEND (Nov. 2009), http://www.minneapolisfed.org/pubs/cd/09-4/CommDiv_2009_4.pdf. Lang continues in the forefront of promoting the L3C idea along with a team of working groups committed to studying and promoting the L3C. See AMS. FOR CMTY. DEV., supra note 2.


purpose test with regard to PRIs if it significantly furthers the accomplishment of the private foundation’s exempt activities, and it was only made because of the relationship between the investment and the foundation’s exempt activities. In other words, the foundation must determine that the foundation’s exempt purposes match the activities of the organization in which it invests in order for the investment to qualify as a PRI.

The income-production test, which requires that no significant purpose of the investment may be the production of income or the appreciation of property, actually means that the investment must be a risky one, one that would not ordinarily attract market-rate investment because of the charitable purposes. If the investment is one that would not attract most investors, and the foundation makes a PRI, the possibility exists that the investment will eventually produce significant income or asset appreciation. In such a case, this occurrence is not conclusive evidence that the foundation has failed this income-production test.

The third requirement, that no purpose can be for the furtherance of lobbying or political campaign activity, appears in the regulations rather than the statute. This requirement helps to ensure that the charitable funds used in a PRI are used for charitable rather than political purposes.

PRIs are exceptions to the jeopardizing-investment rule, which imposes a substantial excise tax on foundations that make risky investments as well as the managers who knowingly authorize them. PRIs also count toward the five percent qualifying distribution requirement—the rule that requires private non-operating foundations to spend at least five percent of an average market value of their previous year’s assets each year on charitable purposes. Foundations traditionally meet this qualifying distribution requirement through grants, for which they receive no return on investment. Because PRIs have the potential to make a return on the investment, they also have the potential to increase the amount of money they can eventually distribute for charitable purposes.

15. Id.; see also § 53.4944-3(b) (Ex. 1) (stating that a below market rate loan to a small business owned by members of an economically disadvantaged minority group in a deteriorated urban area that meets all the requirements of a PRI “is a program-related investment even though [a private foundation] may earn income from the investment in an amount comparable to or higher than earnings from conventional portfolio investments”).
16. Id. § 53.4944-3(a)(1)(iii).
17. I.R.C. § 4944(a) and (b) impose an excise tax on private foundations that engage in high-risk investments unless they meet the definition of a PRI. Id.
Although some foundations make good use of this tool, only 173 of the more than 75,000 foundations in existence in 2007 actually made PRIs that year or the year before. These investments totaled $734 million, less than one percent of the total qualifying distributions foundations made during these two years.

Several reasons exist for the relative dearth of PRIs. Foundations typically give grants instead of making loans or investments, and they may not have expertise or interest in managing these investments. They also typically seek reassurance that such investments actually qualify as PRIs, given the onerous excise taxes they face if they make an incorrect determination. Thus, foundations tend to forego the process entirely, seek a private letter ruling from the IRS or an opinion letter from an attorney before investing in a PRI, or engage in an expensive and time-consuming internal due diligence process.

The architects of the L3C concept reasoned that private foundations would be more likely to use the PRI tool if a legally recognized entity could signal to the foundations that the PRI requirements were met. Presumably, this designation would give private foundations the same confidence the 501(c)(3) designation gives to grantmaking foundations.

The idea was to create a variation of the LLC business form as the signaling device. The LLC is a relatively simple business form that provides both limited liability protection and pass-through tax treatment for its members. It is the most widely-used business form for small businesses.


21. Id.


23. Id. at 258–59; Luther M. Ragin, Jr., V.P. Inv. F.B. Heron Found., The Evolution of PRIs, Address at Stanford University at the Program-Related Investments Conference (Jan. 19, 2006), available at http://primakers.net/files/Luther%20Ragin%20Remarks.doc.

24. A determination letter from the IRS, in response to an application, that an organization is recognized as a 501(c)(3) tax-exempt organization provides foundations and other donors advance assurance of deductibility of contributions. They can rely on this determination unless and until the IRS revokes the determination letter. Rev. Proc. 82-39, 1982-2 C.B.759.

in the United States. It also allows a great deal of flexibility through the members’ operating agreements.

The creators of the L3C adapted the LLC by drafting legislation that incorporates the PRI provisions from the Internal Revenue Code into a state’s law for LLCs. The Vermont L3C statute, for example, amended the existing limited liability statute by adding the definition of “L3C” or “low-profit limited liability company” to the definitions section. That definition requires each L3C to satisfy the following requirements: 1) it must significantly further the accomplishment of one or more charitable or educational purposes within the meaning of § 170(c)(2)(B) of the Internal Revenue Code, and be formed solely as a result of its relationship to the accomplishment of charitable or educational purposes; 2) it cannot have the production of income or the appreciation of property as a significant purpose, although the actual production of significant income or property appreciation is not conclusive evidence of an inappropriate purpose; and 3) its purpose is not to influence any legislation or political campaign. The language tracks the language in the Internal Revenue Code and the Treasury Regulations that relate to PRIs. The Vermont L3C statute also provides that, if any of these requirements are no longer met, the organization will cease being an L3C, but will remain an LLC as long as it meets the LLC requirements.

Like traditional LLCs, the L3C may elect to be a pass-through entity for tax purposes. The L3C itself is not subject to taxation on its income, but its members pay all applicable taxes. Thus, the income is not exempt from taxation unless all its members are tax-exempt entities, and those making investments in the L3C are not entitled to a charitable tax deduction. Unlike traditional LLCs, however, L3Cs must have a primary charitable purpose and steer clear of lobbying and political activity. The L3C is therefore a


26. Id. at 8.

27. Id. at 11. The members (owners) generally create an “operating agreement,” which defines their relationship by contract. Id.

28. Letter from Marcus Owens, Attorney, Caplin & Drysdale, on behalf of Mary Elizabeth & Gordon Mannweiler Found., to Elizabeth Grant, Charitable Activities Section, Or. Dep’t of Justice (July 2, 2009) (on file with Vermont Law Review).

29. Vermont’s limited liability statute is VT. STAT. ANN. tit. 11, §§ 3001–3184 (LexisNexis Supp. 2010). The L3C provision, § 3001(27), is a definition. The remaining LLC provisions apply to L3Cs, which are a sub-set of the LLC.

30. See supra notes 11–12 and accompanying text for a synopsis of the language in the Internal Revenue Code and Treasury Regulations relating to PRIs.


32. Brakman Reiser, supra note 8, at 624.
type of limited liability company that satisfies the requirements of the PRI rules as long as the foundation making the investment also determines that its charitable objectives match the L3C’s objectives.

The L3C is also able to take advantage of the membership flexibility that an LLC offers in order to create a multiple-tiered investment strategy, often called a “tranche mechanism.” The L3C creators reasoned that a private foundation would make the initial investment in an L3C through a PRI. That investment would be the investment with the highest risk and the lowest rate of return. It would provide the initial equity capital to the L3C, which would then give the L3C sufficient capital to attract investors who would otherwise have found the investment too risky. Such investors would then become a part of a separate membership class (or tranche) in the L3C, a class that could expect a higher rate of return than the foundation did. This class might become a middle tranche of investors, those who still accept a below market rate of return in order to encourage a social return. Ultimately, a class of investors who expect a market rate of return could emerge. Thus, the PRI would not only provide capital; it would also leverage additional investment.

The L3C is often touted as a business solution for the newspaper industry. An L3C newspaper would promote community services by providing news, opinion pieces, and cultural reviews, without considering profit as the primary concern. Foundation funds, which expect a high social return and a low monetary return, could serve as the top tier investment, thus making the economic risk more palatable for those investors that seek a higher return. Similarly, an L3C designed to save jobs in an economically depressed area could buy factories, modernize them, and then

33. Kelley, supra note 8, at 373–74.
34. See Woodrow & Davis, supra note 10, at 5 (representing this concept visually); see also Brakman Reiser, supra note 8, at 628–29; Bishop, supra note 22, at 263; Kelley, supra note 8, at 373–74.
36. In May 2010 the first L3C newspaper was created. Peter Fimrite, Point Reyes Paper Sold, Ending Bad Feelings, S.F. CHRON., May 27, 2010, at C1. The proposed Philanthropic Facilitation Act of 2010 includes Section III. An Industry in Need: News Organizations, a four-page discussion of the ways in which the L3C could help the news industry. See AMS. FOR CMTY. DEV., supra note 2, Proposed Federal Legislation, at 3 (click “Proposed Federal Legislation” under “Laws” tab) [hereinafter Philanthropic Facilitation Act]. The Act also proposes that Treasury Regulation § 1.501(c)(3)-1 be amended “to provide that the dissemination of news furthers educational and literary purposes, including without limitation the inclusion of an example under Reg. Sec. 1.501(c)(3)-1(d)(3)(ii).” Id. at 9.
lease them back to manufacturers at a low rate—steps that could help the manufacturers become more competitive and save jobs.\(^{37}\)

As of October 17, 2010, L3C legislation has been introduced in nineteen states.\(^{38}\) Eight states: Vermont, Michigan, Utah, Illinois, Wyoming, Louisiana, North Carolina, and Maine, and two Indian nations: the Oglala Sioux Tribe and the Crow Indian Nation, have passed the legislation. The legislation has been enacted into law in all of those states except Maine.\(^{39}\)

The L3C promoters have also drafted federal legislation, the Philanthropic Facilitation Act of 2010, which would amend § 4944(c) of the Internal Revenue Code to provide a rebuttable presumption that investments in L3Cs qualify as PRIs.\(^{40}\) The legislation and accompanying regulations would set up a voluntary procedure, similar to that now in existence for recognition of a 501(c)(3) tax-exempt organization, that would allow entities to receive an IRS determination that an investment in a specific company qualifies as a PRI for any private foundation with a common purpose.\(^{41}\) Private foundations could then rely on this determination unless and until the Secretary of the Treasury published a notice of revocation.\(^{42}\) The proposed legislation also requires all for-profit organizations receiving PRIs to disclose a considerable amount of financial information, the disbursements made for the exempt purposes, a description of the results obtained from the use of those assets for charitable purposes, and the names and addresses of all private foundations holding PRIs in the organization.\(^{43}\)


\(^{39}\) See supra note 4 (citing state statutes).

\(^{40}\) Philanthropic Facilitation Act, supra note 36, at 8.

\(^{41}\) Id.

\(^{42}\) Id.

\(^{43}\) Id.
The creators of the L3C assume such legislation will give additional confidence to foundations that are wary of PRIs.\footnote{See Elizabeth Carrott Minnigh, Low-Profit Limited Liability Companies: An Unlikely Marriage of For-Profit Entities and Private Foundations, 34 TAX MGMT. EST. GIFTS & TRUSTS J. 209, 214 (2009); Letter from Robert M. Lang, CEO, Mary Elizabeth & Gordon B. Mannweiler Found. to Nat’l Ass’n for State Charity Officials 15 (Apr. 17, 2009) (on file with Vermont Law Review) (discussing an earlier version of the proposed federal legislation).} As of October 15, 2010, such legislation had not yet been introduced in Congress.\footnote{AMS. FOR CMTY. DEV., supra note 2, at Proposed Federal Legislation.}

The L3C concept has received a good deal of praise from commentators, most of whom tout the benefits described above.\footnote{See, e.g., Kelley, supra note 8, at 371–73; Robert R. Keatinge, LLCs and Nonprofit Organizations—For-Profits, Nonprofits, and Hybrids, 42 SUFFOLK U. L. REV. 553 (2009); The L3C: Low-Profit Limited Liability Company Research Brief, CMTY. WEALTH VENTURES, INC. 3 (July 2008), available at http://communitywealth.org (click on “Resources,” then scroll down to “Research Brief: The L3C: Low-Profit Limited Liability Company”) (stating that L3Cs can reduce costs of PRIs, attract investors, and satisfy a philosophic mandate); Minnigh, supra note 44; Jim Witkin, The L3C: A More Creative Capitalism, TRIPLE PUNDIT BLOG (Jan. 15, 2009), http://www.triplepundit.com/pages/the-l3c-a-more-creative-capitalism; Woodrow & Davis, supra note 10; see also John E. Tyler & Marcus Owens, The L3C: A Potentially Useful Tool for Promoting Charitable Purposes, COMMUNITY DIVIDEND (June 2010), http://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=4491 (countering criticisms of the L3C concept by explaining how fiduciary obligations protect the social mission and how L3Cs handle significant profits).} However, critics and skeptics have also come out of the woodwork. They have raised questions about whether the L3C will actually attract PRIs,\footnote{See Bradfield et al., supra note 9 (concluding that L3Cs will not increase PRI investment to any significant extent); Allison Evans et al., L3C: Will New Business Entity Attract Foundation Investment?, 63 EXEMPT ORG. TAX REV. 457 (2009) (arguing that L3C status may serve a role in branding social ventures, but it does not remove the barriers to foundation investment); David Edward Spenard, Panacea or Problem: A State Regulator’s Perspective on the L3C Model, 65 EXEMPT ORG. TAX REV. 131 (2010) (arguing that the current system works and that the L3C concept is not only unnecessary but also potentially harmful).} how to define and enforce the “charitable” and “low-profit” requirements of the legislation,\footnote{Id.} whether the for-profit part of the organization will undermine its charitable mission,\footnote{This argument has two distinct manifestations. One is the fear that the charitable gifts made to the private foundations will find their way into private, profit making hands. See Spenard, supra note 47, at 134 (arguing that the PRI process will increase the risk that charitable assets will be used for subsidizing for-profit ventures); J. William Callison & Daniel S. Kleinberger, When the Law Is Understood. L3C No 3 (William Mitchell Coll. of Law Legal Studies Research Paper Series, Working Paper No. 2010-07, 2010) (arguing certain L3C policies, such as tranched investment, transfer benefit from charities to private businesses). The other argument is that L3Cs are in direct competition with the nonprofit sector for funds. Laura Otten, A Tough Hybrid to Swallow—the L3C, NONPROFIT UNIVERSITY} whether the L3C will deprive the nonprofit sector of much needed funds,\footnote{Rick Cohen, L3C: Pot of Gold or Space Invader, BLUE AVOCADO, Sept. 30, 2009, www.blueavocado.org/content/l3c-pot-gold-or-space-invader.} and whether the new business form is necessary or even helpful.\footnote{Id.}
Although some of the disagreement between the promoters and detractors of the L3C is a matter of language, misunderstanding, or policy, other points of the disagreement rest on assumptions about the way various actors will behave once they have adopted this new business form. Only by examining the operational experiences of actual L3Cs will we be able ultimately to determine whether a new business form is necessary for entrepreneurs, whether foundations will actually free up funds for these new organizations, or whether L3C entrepreneurs will be able to balance the competing goals of charitable purpose and profit. In this respect, the behavior of the actors during the first two years of the L3C era is instructive.

II. The Surveys and the Respondents

A. Methodology

Given that Vermont was the first state to adopt the L3C business form, I decided to contact the early adopters of the L3C there to determine why they chose this business form and whether it was proving a satisfactory choice of entity for their purposes. I was interested in whether they formed the L3Cs to gain access to PRI funds or if they had other reasons for adopting this new business form. I also wondered whether any of their motivations or actions had proved the naysayers correct. Finally, I hoped to explore whether their answers suggested areas for further exploration.

The L3C is, of course, still in its infancy, and its early adopters may not be representative of the types of people and organizations that will appear later. Moreover, L3Cs in Vermont may not be representative of L3Cs in other parts of the country. Nevertheless, the experiences of its early adopters can be informative as policy-makers determine whether to adopt the L3C nationally and in other states or whether to modify it in the states that have already adopted it.

In order to learn about their experiences, I sent letters to the contact person listed for every L3C that had registered with Vermont’s Secretary of State between April 30, 2008 and January 15, 2010. Of the eighty-four letters mailed, thirteen were returned as undeliverable and twenty-eight


52. See VT. SEC’Y OF STATE, supra note 5 (listing all registered L3Cs in Vermont).
L3Cs responded to the survey, a 39% response rate. I later spoke by telephone to nineteen entrepreneurs who had responded to the initial survey and had an email exchange with another respondent. The initial surveys and conversations took place in the fall and winter of 2009. During the summer of 2010 I sent a second survey to those who had responded initially, asking for a follow-up response. I heard from sixteen.\(^{53}\)

I promised anonymity to each respondent. Therefore, anyone who is named in this Article either gave permission for the attribution or has made a similar statement publically. Most of the observations and quotations in this Article are made without attribution. I assigned numbers to each respondent, however, and the footnotes reflect those numbers. Appendix A lists the participating L3Cs. The actual responses to the surveys and the notes from interviews are on file with the Vermont Law Review.

**B. The L3C Pioneer Response**

Leaders of organizations ranging from a motorcycle safety school to the technology arm of an online museum responded. Several organizations promote renewable energy and energy efficiency. Others hope to improve economic conditions in the community by promoting social enterprise, encouraging civic engagement, or saving agricultural jobs. Still others are in the healthcare field—developing innovative medical technologies, promoting healthy lifestyles, and serving the uninsured. One organization hopes to reduce crime through restorative justice. The remaining organizations have educational or literary objectives. Table 1 depicts the population of respondent organizations, according to their own self-classifications.\(^{54}\)

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53. Ten responded to the second survey. The others corresponded either by email or phone. A copy of both written surveys and a list of the questions asked by telephone can be found in Appendix B.

54. Several respondents checked more than one classification. Hence, the number of responses is greater than the number of L3Cs. A list of the L3Cs represented by Table 1 and a short description of each can be found in Appendix A.
The respondents represent small businesses. Most are start-ups. In fact, five were not yet operational when the entrepreneurs responded to the initial survey, and one had already closed up shop by the time I sent the second survey. Many of the entrepreneurs either had other full-time jobs or were retired from full-time jobs, an indication that these L3Cs were not yet sufficiently profitable to provide their founders with a living.

Of those organizations that had been in existence before they became L3Cs, one turned an existing for-profit enterprise into an L3C, three are closely affiliated with LLCs or corporations, and eight are owned by or

<table>
<thead>
<tr>
<th>Table 1: Respondents' Classifications</th>
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<tr>
<td>Animal welfare</td>
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<tr>
<td>Agriculture</td>
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<tr>
<td>Community improvement</td>
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<tr>
<td>Crime reduction</td>
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<tr>
<td>Education</td>
</tr>
<tr>
<td>Energy and environment</td>
</tr>
<tr>
<td>Health</td>
</tr>
<tr>
<td>Museum, art education</td>
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<tr>
<td>Promotion of social enterprise</td>
</tr>
<tr>
<td>Protection against abuse and neglect</td>
</tr>
<tr>
<td>Socially beneficial publishing</td>
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<tr>
<td>Socially beneficial technology</td>
</tr>
</tbody>
</table>

55. Technically, of course, they are all start-ups, but several built upon existing businesses. The L3Cs I have labeled 3, 4, 5, 6, 7, 8, 10, 11, 13, 15, 16, 18, 19, 20, 22, 23, 24, 26, 27, and 28 are new businesses. The rest are affiliated with or derived from other businesses.

56. The L3Cs labeled 4, 8, 18, 19, and 22 responded that they were not yet operational. Those labeled 3 and 5 reported that their L3Cs were in a pilot stage.

57. RBoDS, http://www.rbods.com (last visited Sept. 19, 2010). It is not clear from the website whether the L3C has closed down entirely or if the founders continue to operate it in their spare time. I understood the announcement to say they would continue to support the mission of encouraging a healthy lifestyle but no longer as an enterprise. A second L3C, The Farm at South Village, switched from an L3C to an S-Corporation, but that decision was not because the business failed. Rather, they found they would not be eligible for a grant or for certain tax privileges as an L3C that they could receive as an S-Corporation. See infra note 163 and accompanying text. Two others, the L3Cs labeled 15 and 23, are still in existence, but are not active at this time.

58. The founders of the L3Cs labeled 3, 4, 5, 11, 13, 18, 23, and 25 specifically stated they had other jobs. Those labeled 7 and 17 mentioned they had retired from other jobs. This list does not include those L3Cs that are affiliated with other LLCs or 501(c)(3) organizations if the person who spoke to me was working for both organizations. See infra notes 60–61 for a list of L3Cs affiliated with another organization.

59. L3C labeled 25.

60. L3Cs labeled 8, 15, and 20.
closely affiliated with existing 501(c)(3) organizations.\textsuperscript{61} One respondent runs two related L3Cs.\textsuperscript{62}

As small businesses, many of the organizations described in the survey are owned and managed by a single individual or couple. When asked how the memberships worked in their organizations, eight answered that they are single member organizations,\textsuperscript{63} another eight responded they had two or more members with a single classification,\textsuperscript{64} and four organizations explained they had more than one classification of members.\textsuperscript{65} The other eight respondents did not answer this question.\textsuperscript{66}

Governance and ownership of the L3C would ordinarily be covered by an operating agreement.\textsuperscript{67} However, only eleven of the twenty-eight organizations confirmed that they have written agreements.\textsuperscript{68} All the organizations with different classifications of members had written operating agreements, but the less complex organizations were less likely to have them. As one entrepreneur explained, “When I get other people involved, I will finish the operating agreement.”\textsuperscript{69}

As for management arrangements, eight L3Cs answered that they were member managed\textsuperscript{70} and seven reported that managers filled the management role.\textsuperscript{71} The rest did not respond to the question about management.

Eighteen organizations represented in the survey operate in Vermont, two in Massachusetts, three in New York, and one each in California, Colorado, Maine, New Jersey, Pennsylvania, and Texas.\textsuperscript{72}

Eight women and nineteen men responded to the survey. Four respondents revealed they founded the organization as part of a husband/wife or life partner team.\textsuperscript{73}

\textsuperscript{61.} L3Cs labeled 1, 2, 9, 12, 14, 16, 20, and 28.
\textsuperscript{62.} CF Operations, L3C and CF Real Estate Holding, L3C.
\textsuperscript{63.} L3Cs labeled 6, 8, 10, 15, 17, 20, 22, and 25.
\textsuperscript{64.} L3Cs labeled 4, 7, 12, 14, 19, 21, 24, and 26.
\textsuperscript{65.} L3Cs labeled 3, 11, 13, and 23.
\textsuperscript{66.} L3Cs labeled 1, 2, 5, 9, 16, 18, 27, and 28.
\textsuperscript{67.} Kleinberger, supra note 25, at 11.
\textsuperscript{68.} L3Cs labeled 3, 7, 8, 9, 11, 13, 17, 21, 23, 27, and 28.
\textsuperscript{69.} L3C labeled 5. Those numbered 3 and 6 expressed similar thoughts. Number 3 adopted an operating agreement between the time its founder completed the first and second surveys.
\textsuperscript{70.} L3Cs labeled 4, 5, 7, 13, 16, 17, 22, and 23.
\textsuperscript{71.} L3Cs labeled 8, 9, 11, 18, 19, 24, and 25.
\textsuperscript{72.} All twenty-eight L3Cs are registered in Vermont, but several operate in other states. Appendix A lists the L3Cs and their states of operation.
\textsuperscript{73.} Women responded for the L3Cs labeled 1, 2, 5, 10, 14, 16, 21, and 25; men responded to the rest. Those L3Cs labeled 1, 2, 21, and 24 are operated by couples.
III. EARLY OBSERVATIONS

The major purpose of the questionnaires was to ask the L3C pioneers about their motivations for choosing this business form. Both written surveys requested the entrepreneurs to list every reason for pursuing this business form. The second survey also asked the respondents to state their top priority, and the telephone interviews explored their motivations and priorities in further detail.

The social entrepreneurs who created L3Cs in Vermont within the first year and a half of its existence had almost as many reasons for choosing the L3C business form as they had business purposes. When asked to list all reasons for choosing the L3C business form, the most common response was the desire for PRI funding. The entrepreneurs also recognized that this form fit their mission and that profits were not their primary motive. Their desire for flexibility, control, and to be cutting edge also played prominent roles in this decision. The results from the surveys, in which the respondents mentioned every reason they chose the L3C business form, are summarized in Table 2 below.

Table 2: Reasons for Choosing L3C as a Business Entity

<table>
<thead>
<tr>
<th>Reason</th>
<th>Scale</th>
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<tbody>
<tr>
<td>L3C concept fits mission</td>
<td>10</td>
</tr>
<tr>
<td>Cutting edge factor</td>
<td>10</td>
</tr>
<tr>
<td>Liability protection</td>
<td>10</td>
</tr>
<tr>
<td>Profits not the primary purpose</td>
<td>10</td>
</tr>
<tr>
<td>Hoped to receive PRIs</td>
<td>15</td>
</tr>
<tr>
<td>UBIT and commercial activity concerns</td>
<td>5</td>
</tr>
<tr>
<td>Flexibility</td>
<td>15</td>
</tr>
<tr>
<td>Wanted control</td>
<td>10</td>
</tr>
<tr>
<td>Wanted the &quot;halo effect&quot;</td>
<td>5</td>
</tr>
<tr>
<td>My lawyer suggested it</td>
<td>0</td>
</tr>
<tr>
<td>Cost</td>
<td>0</td>
</tr>
</tbody>
</table>

Once the entrepreneurs’ priorities are taken into account, a slightly different picture emerges. For example, the possibility of receiving PRI funding, while intriguing, was not the most important factor in the entrepreneurs’ decisions to form L3Cs. Instead, Vermont’s social hybrid pioneers saw the need for a hybrid business form, a “for-profit with a
nonprofit soul.” They also responded to the simplicity and flexibility of the L3C, as well as its branding potential. Interestingly, if the L3C had not been an option, these social hybrid pioneers would have chosen to forego the option of setting up a 501(c)(3) organization. In their minds, a sole proprietorship, LLC, or corporation would be preferable to the public charity form, which they saw as too complicated, too restrictive, and over which they would have little or no control. Finally, for the most part, the L3C pioneers remain pleased with their decision to adopt this new business form several months to two years after they formed their businesses. They hold this favorable impression even though PRI funds have not materialized and the L3C business form has actually confused some of their funders and customers.

These observations are spelled out in more detail below, along with quotations and anecdotes from the L3C pioneers who participated in the study, which should clarify the findings.

A. The Possibility of Receiving PRI Funding, While Intriguing, Was Not the Most Important Factor in the Entrepreneurs’ Decisions to Form L3Cs

As established in Part I, the L3C is designed to facilitate foundations’ use of PRIs, and the publicity surrounding this form stresses this purpose. The Vermont Secretary of State’s site, for example, says, “The basic purpose of the L3C is to signal to foundations and donor directed funds that entities formed under this provision intend to conduct their activities in a way that would qualify as [PRIs].” One would expect, then, that the early adopters would choose this business form to take advantage of the PRI possibility.

To some extent, these expectations proved true. All the entrepreneurs who answered the survey or spoke on the phone were aware that the L3C was designed to attract PRIs, and most, but not all, were intrigued by the prospect of PRI funding. However, only two of these adopters said the

74. See supra notes 10–20 and accompanying text. The creators of the L3C were interested in more than PRIs, of course. They understood and hoped to retain the simplicity and flexibility of the LLC form, and they appreciated the branding possibilities of the L3C. AMS. FOR CMTY. DEV., supra note 2 (under “About Us” tab, click “Concept of the L3C”). Nevertheless, if these motivations had been their only concern, the L3C itself would be much simpler, as it would not track the language from I.R.C. § 4944. The L3C critics have also focused on the PRI language to a large extent. See supra notes 48–52 and accompanying text.


76. The L3Cs labeled 3, 4, 5, 6, 7, 8, 10, 11, 13, 14, 18, 20, 23, 26, and 28 checked the box that indicated that they were interested in PRIs when they chose their business entity form. The founder of the L3C labeled 8 specifically stated he was not interested in PRIs, as did Brendan Keleher, the agent
PRI funding was a major factor in their decision to adopt the L3C.\textsuperscript{77} Most of the respondents acknowledged that the possibility of PRI funding was either unimportant or not a major reason they chose the L3C business form.\textsuperscript{78} Several claimed they would have started their social enterprises even if the PRI possibility did not exist.\textsuperscript{79}

The founders of ISC Enterprises, L3C, for example, never considered the possibility of obtaining a PRI when they began this business. ISC Enterprises, L3C solved a problem its parent nonprofit organization faced in China, where the government agreed to work with a socially-oriented for-profit organization, but not with a nonprofit.\textsuperscript{80} Two other entrepreneurs explained that they did not understand PRIs and would not consider that fundraising angle unless and until they did.\textsuperscript{81} Several early adopters had not yet had time to seek a PRI or did not need investment at this time in their organizations’ life.\textsuperscript{82} Some sought funds from governmental units, angel investors,\textsuperscript{83} or other non-foundation institutions instead of foundations.\textsuperscript{84} They might have thought the L3C could leverage additional funds, but they were not focused on receiving these funds from foundations.\textsuperscript{85}

Many wanted to keep open the possibility of receiving a PRI. They either realized that foundations were not yet prepared to make these investments in L3Cs or they themselves were not prepared to ask for funds from foundations.\textsuperscript{86} Nevertheless, the major reason the L3C came into existence—to facilitate PRI funding for social enterprises—was not the major reason these early adopters chose this business form.

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\textsuperscript{77} L3Cs labeled 3 and 16.
\textsuperscript{78} L3Cs labeled 5, 6, 8, 9, 11, 13, 14, 15, 17, 18, 19, 21, 23, 25, and 27.
\textsuperscript{79} L3Cs labeled 4 and 6.
\textsuperscript{80} E-mail from Brendan Keleher to author, supra note 76.
\textsuperscript{81} L3Cs labeled 5 and 17.
\textsuperscript{82} L3Cs labeled 5, 6, 14, 19, and 21.
\textsuperscript{83} “An angel [investor] is a wealthy individual willing to invest in a company at its earlier stages in exchange for an ownership stake, often in the form of preferred stock or convertible debt.” Colleen DeBaise, \textit{What’s An Angel Investor?}, WALL S. J., Apr. 18, 2010, http://online.wsj.com/article/SB1000142405270230349130457518420191459904.html.
\textsuperscript{84} L3Cs labeled 6, 14, 15, 17, 19, and 25.
\textsuperscript{85} The founder of the L3C labeled 17 believes, for example, that the L3C designation helped the L3C obtain funds from an angel investor.
\textsuperscript{86} L3Cs labeled 15 and 23 specifically stated that they were uninterested in PRIs at this point, but that they were set up to receive them if the opportunity arose later.
B. The L3C Fit the Entrepreneurs’ Business Needs for a Legal Entity that Bridged the For-Profit and Nonprofit Worlds

Far more important than the PRI to most of the L3C entrepreneurs was the idea that a business form had appeared that fit the type of business they were trying to create. Repeatedly, the respondents told me that their concept was neither a for-profit nor a nonprofit concept. Rather, they truly hoped to form a “for-profit with a nonprofit soul.”

For some, the L3C is a statement of values. I heard phrases like “aligned with my values,” “aligned with our mission,” and “there could not be a better business form for us.” The entrepreneurs were delighted to find a business entity that allowed them to pursue their dual values of improving the community and operating a sustainable market-responsive enterprise. As Michael Harp, the CEO of H2O, L3C, said, “Seeing a business entity type that is a hybrid with a double bottom line, with social impact and creation of social value foremost, fits me . . . [The L3C] brings ‘venture philanthropy’ to life.” Will Raap of The Farm at South Village offered a more philosophical perspective with a similar theme: “It is central to hold an idea that might find long term expression, not from a return on investment but as an ultimate steward or champion of the effort.”

Whether the mission was saving children’s lives or the environment, encouraging social enterprise or storytelling, improving physical fitness or energy efficiency, the social commitment was palpable. Mark Benz, founder of Safer Pediatric Imaging, L3C noted that “anyone who is moved to do an L3C is carrying something on their soul—they feel something is not right.” They are also called to action. Michael Harp undoubtedly spoke for many when he declared, “I’m going to leave this world leaving a mark.”

Making a large return on investment was not the major focus for any of these entrepreneurs. Fully 60% of the respondents to the initial survey checked the box that said, “Realized that profits alone were not the

87. See Coren & Lang, supra note 6, for the origin of the phrase.
88. L3Cs labeled 5, 19, and 24 are quoted. L3C 8 expressed similar sentiments.
89. E-mail from Michael Harp, CEO, H2O, L3C, to author (July 13, 2010 14:45 EDT) (on file with Vermont Law Review).
90. E-mail from Will Raap, Founder, The Farm at South Village, L3C, to author (July 16, 2010 11:15 EDT) (on file with Vermont Law Review).
91. E-mail from Mark Benz, Founder, Safer Pediatric Imaging, L3C, to author (July 16, 2010 08:22 EDT) (on file with Vermont Law Review).
motivation for this enterprise." As Robert Lang said in his capacity as founder of L3C Advisors, L3C, “We have lost the concept that you can make money even if you don’t make a nifty return and [still] make people happy. As long as folks have jobs and can buy dinner, it’s a good thing. Who cares if you do not meet the return on investment that Wall Street expects?” Other L3C pioneers echoed this thought. I heard, “We aren’t in this to make a profit . . . . We want to help others with [a] problem,” and “We didn’t want [our] future dictated by profits over social good.”

Not all the entrepreneurs were completely idealistic. Several realized they could not make a profit anyway. As Matthew Rudikoff, Executive Director of Institute for Public Financial Incentives, L3C, said, “I never made any money to speak of in any of my other business formations so the L3C was perfect for me!” One entrepreneur hoped to be paid back, although he did not care if he made a profit. Others hoped to make a good return on their investment eventually, but realized it would take a long time, if ever, to achieve that goal. Nonetheless, they all planned, as the legislation requires, to have the charitable mission trump any profit motive.

Several of the L3C pioneers had economic reasons, beyond the branding potential of the L3C that is discussed below, for choosing this business form. Some wanted to hedge their bets by choosing a form that could accept grants as well as investments, a structure that would work particularly well if the L3C were associated with a 501(c)(3). Others found that their business models fit well with the L3C structure.

Sustainable Timber Investment Exchange, L3C, for example, is a timber harvesting company that uses sustainable and ecological harvesting techniques. Without such a system, the inherent pressures of owning and financing expensive equipment make it difficult for harvesters to consider anything other than traditional methods. A PRI could ease the financial pressures and provide enough breathing room for a harvesting company to

93. See Table 2.
94. Telephone Interview with Robert Lang, Founder, L3C Advisors, L3C (Oct. 30, 2009).
95. L3Cs labeled 13 and 26, respectively.
97. L3C labeled 28.
98. L3Cs labeled 11 and 23.
99. See supra notes 1, 7; see also infra note 109 and accompanying text.
100. L3Cs labeled 7, 10, and 20.
101. The second survey asked whether “the business form itself fit with the mission of the organization.” Seven of the eight respondents to the survey said “yes.” Appendix B lists the survey questions.
engage in less profitable, but more ecologically friendly, forestry practices, such as timber stand improvement, erosion control, and invasive species management.\textsuperscript{102}

Safer Pediatric Imaging, L3C, a research organization devoted to improving CT scan safety through better X-ray technology, provides another example. Its founder, Mark Benz, was haunted by the statistic that 3,000 of the six million children who receive CT scans each year will develop cancer later in life as a result of their scans. Benz developed a theory about a way to make CT scan technology safer, but funding to test his hypothesis proved elusive. Investors who expect a quick return on investment will not invest at the hypothesis stage because the investment is too risky.\textsuperscript{103} Even foundations, Benz found, require some experimental evidence of promise before they will provide a grant. Benz eventually found a group of individuals willing to provide funding for the initial experiment without receiving a return on investment. Ultimately, Benz expects this organization to be self-sustaining.\textsuperscript{104}

Almost all the other L3C founders had similar stories. For one reason or another, a purely for-profit model did not work well. For different, but equally compelling reasons, a nonprofit did not fit either.\textsuperscript{105} As Robert Hart of rBods.com, L3C explained on his website:

\begin{quote}
[W]e started attending Venture Capital conferences in search of partners to get started . . . . Unfortunately, the extreme emphasis on profits didn’t fit our plan for creating a social network with a primary focus on creating . . . a healthier, happier society with less debt . . . . So then we looked at the nonprofit model. That didn’t fit either. As a businessman I just couldn’t see myself asking for donations every year to sustain a business that I knew was capable of carrying itself within a few years . . . . I can’t tell you how delighted Cat and I were when we discovered the L3C business form! It fits our company to a T!\textsuperscript{106}
\end{quote}

\begin{itemize}
\item \textsuperscript{102} E-mail from Eli Gould, Founder, Sustainable Timber Investment Exchange, L3C, to author (Aug. 26, 2010, 08:03 EDT) (on file with Vermont Law Review).
\item \textsuperscript{103} E-mail from Mark Benz to author, supra note 91.
\item \textsuperscript{104} Id.
\item \textsuperscript{105} Besides the L3Cs described supra notes 96–98, the L3Cs labeled 3, 4, 11, and 24 specifically mentioned that their ideas were “on the fence” between existing business forms.
\item \textsuperscript{106} Robert Hart, founder of rBods.com, supra note 57. Bill Eldridge, of Maine’s MOO Milk, echoed Hart’s sentiment and commented that the L3C fits their mission, structure, and purpose perfectly and allows them to focus their fundraising on socially responsible investors. E-mail from Bill Eldridge, CEO and Chairman, Maine’s Own Organic Milk Co., L3C, to author (July 15, 2010, 16:24 EDT) (on file with Vermont Law Review).
\end{itemize}
According to several L3C pioneers, a social-hybrid business form is both a perfect fit for their organizations and a perfect fit for our times. “The L3C was created for organizations that want to operate at the intersection of mission and profit,” said Rick Zwetsch of interSector Partners, L3C. “We had been trying for 10+ years to figure out how to weave together 50+ years of for-profit, nonprofit and government agency experience. In our minds, there is no better way to do that than with the L3C.”

C. The Simplicity and Flexibility of the L3C were Important Considerations in Choosing a Business Form, as was its Branding Potential

However appealing the hybrid nature of the L3C, its early adopters also welcomed its simplicity, flexibility, and branding potential. “It was a very simple process. That’s my prime reason [for choosing the L3C],” explained Jon Kidde, founder of Green Omega, L3C, an organization that brings restorative justice to Vermont’s institutions. He was not alone. Several others credited the L3C’s flexibility as the main factor in their decision to use the L3C business form.

Even those who did not consider flexibility the primary reason for choosing the L3C business form appreciated that factor. Several respondents were pleased they could pilot their idea without investing the time and money that a more complex business form would take. Others did not want complex legal issues to complicate their ability to start addressing their social goals. Still others could not spare the time. Maine’s Own Organic (MOO) Milk Company, L3C, for example, began when a group of organic dairy farmers realized that they could set up their own distributorship in order to prevent the loss of agricultural jobs once their original distributor ceased operations. MOO Milk’s CEO and Chairman, Bill Eldridge, found the speed with which they could begin operations to be crucial. A more complicated process, such as starting a nonprofit co-op, would have failed because “you can’t herd farmers.”

Not only did this new business form offer flexibility, but it also gave the entrepreneurs an opportunity to project their business values to
customers and investors. Approximately one-third responded to the written survey that they had chosen the L3C business form for its “halo” effect, and the same fraction stated that they wanted to be on the cutting edge of a social movement. In the telephone interviews, several commented that the L3C had a branding advantage. “There are millions of LLCs out there. How can you tell, just from their name, that they have a social mission?” asked Rick Zwetsch of interSector Partners, L3C. Michael Harp of H2O, L3C had a similar response: “To go through normal channels of grant making reduces us to another pretty face at the dance.” They and others recognize that L3Cs need substance as well as a name, but they also see an opportunity to be recognized as socially-motivated innovators.

D. Had the L3C not been Available as a Business Form, the L3C Pioneers Would have Chosen a For-Profit Entity Over a 501(c)(3)

Despite their emphasis on social mission and their plan to proclaim this mission publicly, none of the surveyed entrepreneurs would have chosen to create 501(c)(3) organizations. Some faced insurmountable obstacles that precluded this option, but for most, the complexity and accompanying loss of control were simply too daunting. Some also had philosophical reasons for shying away from the nonprofit model. They held these beliefs despite, or perhaps because of, widespread familiarity with the nonprofit sector.

113. See supra Table 2. This interest was both personal, because they were proud of their mission, and professional, because they hoped to get extra attention. L3Cs labeled 6, 17, and 24 specifically mentioned that they hoped the newness of their business form would help attract investors and business.

114. Telephone Interview with Rick Zwetsch, Founder, interSector Partners, L3C (July 1, 2010).

115. Telephone Interview with Michael Harp, CEO H2O, L3C (Oct. 30, 2010).

116. The opportunity to be on the cutting edge of a social movement and/or receive a “halo effect” from the L3C was mentioned by 3, 4, 5, 7, 8, 10, 16, 19, 20, 22, 24, 27, and 28.

117. InterSector Partners, L3C interviewed people associated with twenty L3Cs (none of which participated in this study) and drew the same conclusion:

They do not want to be a traditional, 501(c)(3) nonprofit because they do not want to be constrained by the strict compliance of the 501(c)(3) world. While most of their businesses and business ideas have a very nonprofit slant in terms of mission, these entrepreneurs do believe they can turn a fair profit—enough that if a foundation took on some of the risk, private investors would be able to see a near market-rate return. Quite a few have background in the nonprofit sector and see the vulnerability and challenges facing that sector—particularly the constraints facing social enterprises under that model.


118. The founders of L3Cs labeled 5, 9, 15, 18, 21, and 24 mentioned their nonprofit backgrounds. Ironically, several of these founders remain associated with 501(c)(3)s, and one, the L3C
Two of the L3Cs represented in this study could not be organized as nonprofit organizations. ISC Enterprises, L3C came into being once it became obvious the Chinese Government would not approve the environmental initiative that its parent, the Institute for Sustainable Communities, had proposed unless it was organized in a for-profit business form.\(^{119}\) Community Health Development Ventures, L3C, an organization that brings health facilities to uninsured and underinsured areas, found that combining the regulatory hurdles of a medical provider in this market with those of a 501(c)(3) would be like "trying to thread a needle with a rope."\(^{120}\) In other words, it was so impracticable as to be impossible.

For the other entrepreneurs, however, a 501(c)(3) could have been a viable option. After all, in order to qualify as L3Cs these organizations must have a charitable or educational purpose equivalent to that which would be recognized under § 501(c)(3).\(^{121}\) Nevertheless, these entrepreneurs did not want to jump through the hoops necessary to obtain and maintain recognition as a 501(c)(3). A 501(c)(3) requires considerable state and federal paperwork. The Form 1023 alone, without schedules and attachments, is twenty-eight pages long.\(^{122}\) The IRS estimates that a novice would need more than one hundred hours to prepare this form.\(^{123}\) It also estimates that even the simplest, most complete Form 1023 takes about ninety days to process; complicated ones take much longer.\(^{124}\)

The L3C, on the other hand, is quite simple to form. The entrepreneur simply finds the one-page document online, checks the box that states it meets the L3C requirements, and pays a fee. It is then legally in business.\(^{125}\)

[labeled 20, eventually did create a 501(c)(3) to be affiliated with the L3C in response to difficulty in obtaining funding as an L3C. See infra Section E.

119. E-mail from Brendan Keleher, supra note 76.
120. Telephone Interview with James Reeb, Founder, Cmty. Health Dev. Ventures, L3C (Feb. 12, 2010).
121. See supra notes 29–31 and accompanying text.
Moreover, once in business, those operating the L3C need not worry about private inurement, the unrelated business income tax, excess benefit transactions, or any of the other myriad rules and regulations that 501(c)(3) organizations must follow.\footnote{126}{If the LC3 receives funding from a 501(c)(3) private foundation, that foundation must still be aware of all the legal rules governing it and its expenditures. The L3C may find life somewhat more complicated as it deals with the foundation’s concern about following the tax rules. The L3C itself, however, is not a tax-exempt entity and does not have these concerns.}

The loss of control over enterprises set up as 501(c)(3) organizations was another concern for many entrepreneurs. The CEO of one organization, which would have a better chance at funding if affiliated with a university, was worried about the bureaucracy and lack of control that such an affiliation would entail.\footnote{127}{L3C labeled 17.} Two others had a significant amount of intellectual property that they wanted to own, even as that intellectual property was being used for charitable and educational purposes.\footnote{128}{L3Cs labeled 7, 14, and 21. The L3C labeled 17 also had intellectual property concerns.} One worried that she would never recoup her investment if she switched to a for-profit business entity.\footnote{129}{L3C labeled 25. As an attorney, I am aware that some of the L3C founders’ concerns could be addressed in a 501(c)(3), but their perceptions led them to their decision to form an L3C. In any case, dealing with these concerns as a 501(c)(3) would have been more legally difficult than using a for-profit vehicle.} Several others knew that nonprofits were run by a board of directors who held the reins of power, and they would have no legal control if they became a 501(c)(3).\footnote{130}{L3Cs labeled 3, 5, 15, 21, and 24 mentioned this loss of control. The founder of the L3C labeled 6 was not concerned about this factor. He believed that someone with real vision and direction could work well with a board that would provide resources and perspectives so that the vision could be advanced in a more thoughtful way. Despite this defense of 501(c)(3) governance, he did not want to start a 501(c)(3) organization.} Many of them had experience with the nonprofit sector and did not want to replicate what they had seen.\footnote{131}{See supra note 118.}

Several respondents hoped to make money and saw nothing wrong with that desire. The idea that one must lose ownership of ideas, plans, and all potential profit in order to make a social difference was anathema to some, perplexing to others. Noah Pollock spoke for many when he said, “Ownership is nice.”\footnote{132}{E-mail from Noah Pollock, Project Dir., Community Energy Exchange, L3C to author (Aug. 24, 2010, 08:32 EDT).}

Finally, the nonprofit option contradicted strongly-held beliefs of some entrepreneurs. Two L3C adopters questioned the 501(c)(3) option because they believed that even social ventures should respond to market forces.\footnote{133}{L3Cs labeled 7 and 25.}
Another survey respondent worried that employees of 501(c)(3) organizations tended to burn out because they are not paid well. He wanted to treat his employees better than that.\textsuperscript{134} A third survey respondent thought it immoral to ask for donations to sustain a business that could be self-supporting within a few years.\textsuperscript{135}

This unwillingness to start a nonprofit organization was something of a paradox, both because so many of the entrepreneurs had experience in the sector and because so many of the L3Cs are affiliated with 501(c)(3)s.\textsuperscript{136} The sample in this study is not unusual, however. InterSector Partners, L3C also conducted a study of L3C entrepreneurs, none of whom overlapped with this study. That study also concluded that the 501(c)(3) form was an unacceptable alternative.\textsuperscript{137}

\textit{E. For the Most Part, the L3C Business Form has not Provided a Branding or Fundraising Advantage to these Entrepreneurs}

The novelty of the L3C has proven to be double-edged for these entrepreneurs. It has led to some press coverage\textsuperscript{138} and the occasional customer. One L3C, for example, attracted a customer who assumed that an entity organized as an L3C would be more innovative than a similar organization.\textsuperscript{139} Another L3C, however, was unable to purchase liability insurance because the insurance company had no code for “L3C.”\textsuperscript{140} A third L3C faced a higher than expected rent payment because the organization did not qualify for nonprofit rates,\textsuperscript{141} and a fourth L3C lost a potential individual donor to its affiliated 501(c)(3) because the donor did not trust the L3C to keep the 501(c)(3)’s mission paramount.\textsuperscript{142}

Almost all the entrepreneurs recognized that the newness of the L3C had failed to bring the caché they had hoped. Only three entrepreneurs

\begin{itemize}
\item \textsuperscript{134} L3C labeled 3.
\item \textsuperscript{135} Robert Hart, founder of rBods.com, \textit{supra} note 57.
\item \textsuperscript{136} It is also ironic, given how many entrepreneurs have found the need to establish a 501(c)(3) or create a fiscal agency relationship with another charity in order to receive funding from foundations. \textit{See infra} notes 154–60 and accompanying text.
\item \textsuperscript{137} \textit{INTERSECTOR PARTNERS, L3C, supra} note 117.
\item \textsuperscript{138} \textit{See, e.g.}, Sharon Kiley Mack, \textit{True Yankee Ingenuity Launches MOOMilk, Maine Organic Milk Producers Form Company to Save Farms}, \textit{BANGOR DAILY NEWS}, Oct. 10, 2009, at Cl; Grant Williams, \textit{Dozens of Companies Are Sprouting with the Intention of Doing Good}, \textit{CHRON. OF PHILANTHROPY} (Nov. 12, 2009), \url{http://philanthropy.com/article/Dozens-of-Companies-Are-Spr/57786}; \textit{see also} Welker, \textit{supra} note 37 (discussing L3C legislation introduced in North Carolina).
\item \textsuperscript{139} L3C labeled 24.
\item \textsuperscript{140} L3C labeled 6.
\item \textsuperscript{141} L3C labeled 25.
\item \textsuperscript{142} L3C labeled 21.
\end{itemize}
suggested the L3C status had been helpful in any respect. The others noted that the L3C was a “confusing” and “untested concept,” and “people have no clue what it is.” One entrepreneur, who had originally thought the L3C would signal to investors that profit was not the main motive, found such confusion among potential investors that he has temporarily shelved the L3C he founded.

Although the general public may not understand L3Cs, many of the entrepreneurs expected foundations to be up to speed on this concept, given that the L3C was designed to facilitate foundations’ use of PRIs. These expectations proved wrong. When asked how their ideas about L3Cs had changed since they started their businesses, I heard several variations of the following: “It turns out foundations do not recognize our ‘in between’ status at all and won’t fund us.” Some early adopters realized that the L3C was an untested concept and had lower, more realistic expectations. None of the responding L3Cs has received a PRI.

The financial experiences of these organizations have been varied. Some L3Cs are struggling. At least one has apparently shut down for lack of funds, and a second is close to closing. A few exist on a shoestring budget, and one sent one-half of the husband–wife management team back to full-time work.

Nevertheless, several L3Cs have succeeded in attracting investment, much of it from outside the foundation world. Three L3Cs received funding from their own members, two from angel investors, and another received a Small Business Administration loan. The rest did not share how they funded their operations except to state that they had not received a PRI from a foundation.

The experiences with foundations have not been entirely negative. One L3C entrepreneur recounted that even though two foundations “looked at us as if we were crazy,” he remained hopeful that the third would provide funding. Three others were also hopeful at the time of the initial

143. L3Cs labeled 11, 17, and 24.
144. L3Cs labeled 3, 5, 6, 8, 14, 16, 23, and 25.
145. L3C labeled 15.
146. L3Cs labeled 6, 14, 16, and 18 mentioned this difficulty.
147. L3Cs labeled 3 and 15 mentioned they knew the L3C would be unknown to most investors.
148. RBods, L3C has already been identified as the one that may have closed. See supra note 57. The others mentioned in this paragraph are L3Cs labeled 5, 13, 21, and 25. Three other L3Cs have either dissolved or are not currently in use, but those decisions appear to be strategic business decisions rather than business failures. See supra note 57, infra notes 161–63 and accompanying text.
149. L3Cs labeled 3, 11, and 28.
150. L3Cs labeled 7, 15, and 17.
151. L3C labeled 14.
152. L3C labeled 11.
Three entrepreneurs did receive foundation grant-funding, but they needed to go through complex legal hoops to do so. One found it necessary to set up an affiliated 501(c)(3) to receive foundation and governmental funding, and two others created a fiscal sponsorship to receive grants from foundations. Evidently, the charitable missions of these L3Cs were attractive to foundations, but the foundations were still too leery of PRIs to provide the funds through that vehicle.

InterSector Partners’ L3C study made a similar finding. None of the entrepreneurs interviewed in that study had received PRI funds, but two L3Cs had attracted foundation investments. In the first case, the parent organization, a 501(c)(3), received a grant for the purpose of creating the L3C. The second was a direct grant from the Bill and Melinda Gates Foundation to redesign and re-engineer cold-chain containers used in vaccine and disease-monitoring programs. This grant was made under the federal tax code’s expenditure responsibility provisions, which allow foundations to make grants to organizations that are not classified as public charities so long as the foundations provide assurances that the grants are used for charitable purposes. Thus, even those L3Cs that have attracted foundation funding did so through a mechanism other than a PRI, most often by affiliating with a 501(c)(3) organization.

Interestingly, three other organizations have either used affiliated for-profit entities or converted to a for-profit in order to obtain funds. As mentioned above, one entrepreneur chose to conduct his business through other entities until the L3C is better known. Another decided to keep the

153. L3Cs labeled 7, 17, and 18.
154. L3C labeled 20. The L3C may also have received a direct grant from a foundation that used expenditure responsibility. Its founder mentioned a grant from a legitimate foundation for which he completed several forms. He emphasized that it was a gift, not a loan or an investment.
155. L3Cs labeled 17 and 18. L3C labeled 17 incurred legal fees for setting up the fiscal sponsorship, which equaled 10% of the grant. In a fiscal sponsorship, an independent project is sponsored by a legally recognized 501(c)(3) public charity in order to gain tax-exempt status. Frequently Asked Questions, FOUND. CTR., http://foundationcenter.org/getstarted/faqs/html/fiscal_agent.html (last visited Sept. 14, 2010).
156. See INTERSECTOR PARTNERS, L3C, supra note 117, at 12–15 (explaining the difficulties in obtaining funding and the limited understanding of L3Cs and PRIs in the foundation community).
157. Id. at 14.
158. Id.
159. Id.
160. Id.; see also I.R.C. § 4945(h) (West 2010) (spelling out expenditure responsibility provisions).
161. L3C labeled 15.
L3C in reserve until the federal legislation has passed.\textsuperscript{162} The third, the Farm at South Village, L3C, a community-based organic farm, actually converted to a Subchapter S corporation\textsuperscript{163} in July 2010, because the federal government did not recognize the L3C in two situations for which The Farm at South Village needed such recognition. The government would not make a much needed solar energy Rural Energy for America Program (REAP) grant to an L3C,\textsuperscript{164} and it would only allow I.R.C. § 1042 capital gains treatment of ESOP (employee stock ownership plan) stock proceeds in a corporation.\textsuperscript{165}

In sum, most of the L3C pioneers remain in business, but many have found it necessary to use more traditional business forms in order to attract investment. Foundations have not yet been willing to provide PRIs, and the L3C status has not been particularly helpful in attracting funds.

\textbf{F. Vermont’s Social Hybrid Pioneers Remain Pleased with the L3C Business Form Despite its Relative Obscurity and their Inability to Secure PRI Funding}

However difficult it has been for the L3C pioneers to obtain funding and begin operations, their frustrations have not translated into dissatisfaction with their L3C choice. All but two of the survey respondents answered the question, “Do you still believe the L3C is the best business form for your venture?” with “Yes.”\textsuperscript{166} This degree of enthusiasm for the concept seems surprising at first blush. The L3C pioneers recognize, however, that they are early adopters, and the L3C remains in its infancy. Further, most of them are fortunate to be weathering difficult economic conditions. Their enthusiasm also confirms my observation that the goal of obtaining PRIs was lower on their priority lists than the opportunity to build mission-driven businesses. As described above, they chose this business form because it reflected their values, and it continues to do so, even if it has not produced the funding or

\textsuperscript{162} L3C labeled 23.
\textsuperscript{163} An S corporation is a small business corporation with no more than 100 shareholders that elects to pass corporate income, losses, deductions, and credit through to its shareholders for federal tax purposes. I.R.C. §§ 1361–1363 (West 2010).
\textsuperscript{164} E-mail from Will Raap, Founder, The Farm at South Village, to author (July 16, 2010, 23:19 EDT) (on file with Vermont Law Review).
\textsuperscript{165} Id.
\textsuperscript{166} See Appendix B for the list of questions. The respondents from the L3C that may have closed, rBods.com, and the one that changed to an S Corporation, The Farm at South Village, both remain enthusiastic about the L3C concept. rBODS.COM, supra note 57; E-mail from Will Raap, supra note 164.
recognition initially anticipated. Although the architects of the L3C concept correctly identified capitalization as a concern for social entrepreneurs, their concept tapped even more strongly into a desire to find a relatively simple and flexible way to improve the human condition.

IV. QUESTIONS TO PONDER

These findings, while obviously still preliminary, can provide food for thought for both proponents and skeptics of the L3C. What significance should attach to the finding that the architects of the L3C concept have a different approach than the entrepreneurs who embrace it? Why has this disconnect occurred and why have the L3Cs not attracted PRI funds? Should policy makers take note, or do these differences simply suggest a slight shift of emphasis and the young age of the L3C? What can, or should, policy makers learn from the L3C pioneers’ aversion to the 501(c)(3) or their enthusiasm for a business form that has yet to produce the promised benefits?

A. Why are the L3C Pioneers’ Priorities Different from those of the L3C Architects, and why have they not yet Attracted PRIs?

In many respects, the differences in priorities could have been predicted. An L3C is basically an LLC that satisfies the requirements for a PRI. However symbiotic the LLC and PRI concepts may be as a matter of public policy, they are rather strange bedfellows in terms of their relative complexity. The strength of the LLC is its simplicity and flexibility. Entrepreneurs can gain the limited liability features of a corporation and the tax efficiencies and operational flexibility of a partnership by completing a few forms and paying a registration fee. In contrast, the PRI is anything but simple. Even sophisticated foundations with millions of dollars in assets find them too complex to undertake. It is hardly surprising that entrepreneurs, who are often creating new organizations as single-member entities, are more attracted to the simplicity of the L3C than the complexity of the PRI.

The lack of response from the foundation community is equally

167. See supra notes 25–27 and accompanying text.
168. See, e.g., VT, SEC’Y OF STATE, Limited Liability Companies, http://www.sec.state.vt.us/tutor/dobiz/dobiz18.htm (last visited Sept. 13, 2010). Deborah Markowitz, Vermont’s Secretary of State, emphasized when the L3C statute passed that the State’s role was one of registration, not regulation. Dan McLean, State to Host a New Type of Company, BURLINGTON FREE PRESS, Apr.20, 2008, at C6.
169. See supra note 23 and accompanying text.
unsurprising. Social entrepreneurs, particularly those adventurous enough to start the first few L3Cs in the country, tend to be risk-takers. Foundations, on the other hand, have millions of dollars to protect, tax compliance issues to monitor, and lawyers advising them at every step to be cautious. If, as the creators of the L3C concept have recognized, foundations are leery of PRIs in general, foundations will at least initially be equally leery of making PRIs to enterprises that have adopted an untested business form. Passage of federal legislation that would provide a presumption that an organization meets the requirements of a PRI could help ease foundations’ concerns, but that legislation has not yet been introduced, much less passed or enacted. Even if the legislation is passed, foundations will need to determine whether the L3C’s charitable mission complements its own and will need to conduct expenditure responsibility (due diligence) over the course of the investment. As other commentators have noted, these steps in themselves may be so onerous that the federal legislation will not allay their fears.\textsuperscript{170}

The tepid response from foundations is also unsurprising considering the Vermont L3C statute passed a few months before the United States began its worst economic downturn since the Great Depression.\textsuperscript{171} Unlike some of the earlier recessions, this one has taken an especially hard toll on small businesses.\textsuperscript{172} It has also taken quite a toll on foundations, which decreased their payouts significantly during the past year as a result of their diminished endowments.\textsuperscript{173} One could hardly imagine a worse time to start a small business, especially one that sought funding from a foundation.

Finally, Vermont’s L3C statute will have been in effect for two-and-one-half years as this Article is published. The winds of change may simply take longer to arrive than many had hoped.

\textbf{B. Is the L3C’s Emphasis on PRIs Misplaced? Have its Creators Focused on the Wrong Issue?}

At first glance, it could appear that the inventors of the L3C missed the mark by focusing on the PRI. The entrepreneurs are relatively uninterested

\textsuperscript{170} Kleinberger, supra note 25; Spenard, supra note 47, at 135.
in PRIs, and foundations appear unwilling to use them. The secondary message of the L3C, that it is a way to signal a charitable purpose through a flexible business form, is the one that resonates with the social-hybrid pioneers. Legislators and policy-makers may eventually consider separating these messages.

It would be premature to declare the emphasis on PRIs misplaced, however. First, as mentioned above, the concept is in its infancy. It has had early legislative success in a few states, but it is untested in the vast majority of states and the federal government. If the L3C gains traction over the next few years and PRIs become more widely available, the entrepreneurs’ and foundations’ priorities will undoubtedly change.

Second, access to PRIs may not be the top priority of the L3C pioneers, but access to capital remains a concern. The L3C is flexible enough to allow for other types of investment, and the tranche mechanism available through the L3C is a creative way to allow for the different rates of return for different classes of members that may be necessary to capitalize these businesses.

Finally, the L3C concept has already had an effect. In its first two-and-a-half years, it has inspired almost 250 entrepreneurs to create social ventures in the states that have passed L3C legislation.\(^1\)\(^7\)\(^4\) The concept has also spawned numerous newspaper, law review, and business journal articles.\(^1\)\(^7\)\(^5\) The changes may be more inspirational than legal, for the opportunity to receive PRIs already exists with other business forms.\(^1\)\(^7\)\(^6\) Nevertheless, the publicity alone can help raise foundations’ consciousness about and comfort level with the PRI tool, which could in turn lead to a greater use of PRIs. Such a result would thus accomplish a major goal of the L3C legislation, even if the L3C never gains widespread acceptance.

\section{C. Is the L3C Necessary or do Existing Business Forms Meet Entrepreneurial Needs?}

The differences in priorities point to other questions, however. First, one of the criticisms directed to the L3C concept is that this new business form is unnecessary. These critics maintain that private foundations have been authorized to make PRIs for over forty years, and LLCs already offer the tranching opportunity described above.\(^1\)\(^7\)\(^7\) Given this argument, it

\begin{itemize}
\item \(^{174}\) See \textsc{Intersector Partners}, L3C, http://www.intersectorl3c.com/l3ctally.html (last visited July 20, 2010) (maintaining a running tally of L3Cs in all the states that have passed L3C legislation).
\item \(^{175}\) See supra notes 33–35, 47–51.
\item \(^{176}\) See supra note 10.
\item \(^{177}\) See supra note 47 and accompanying text.
\end{itemize}
follows that a new label is unlikely to change foundations’ reluctance to offer PRIs, especially when the L3Cs are not particularly enthusiastic about receiving them. In fact, the entrepreneurs’ relative disinterest in PRIs could add to the arguments that this new business form is unnecessary.

The problem with this argument, however, is that other aspects of the L3C have struck a chord with those entrepreneurs who wish to retain control over a relatively simple enterprise and still proclaim their social mission. In the entrepreneurs’ minds, no other business form offers this possibility. A 501(c)(3) organization signals its social mission through its charitable status, but the founder loses legal control of the organization. Founders of for-profit organizations retain control to the extent that investors and business partners allow, but they cannot announce their social intentions through the business form itself. The benefit corporation, a new business form that has been recognized in Vermont and Maryland, may ultimately provide an alternative for many of these entrepreneurs. However, the underlying business model is a corporation, which lacks the L3C’s simplicity and tax advantages. The entrepreneurs could also create a combination of for-profit and nonprofit enterprises through joint ventures and subsidiaries, but these options seem too complex to undertake.

The L3C, on the other hand, with its relative simplicity and its “for-profit with the nonprofit soul” message, meets these entrepreneurs’ business needs. The critics who claim the L3C legal form is unnecessary may have a valid legal argument. However, the L3C entrepreneurs’ response suggests that, as a practical matter, they are wrong. The L3C has definitely provided them with a business form that, at least in their perception, was not available before the advent of the L3C.

**D. Is the L3C the Best Business Form for Enterprises that are not Interested in PRIs?**

The more relevant question may be whether the L3C is the best form for those entrepreneurs who are more interested in the “for-profit with the nonprofit soul” message than the opportunity to receive PRIs. Common sense suggests that a business entity authorized by legislation that tracks the tax code’s language permitting PRIs may not be the most appropriate vehicle for organizations that are uninterested in such investments. Perhaps the entrepreneurs who do not seek PRIs should register as LLCs and then obtain a B certificate instead of forming L3Cs. Or perhaps a new

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178. See supra notes 106–107 and accompanying text.
179. See supra note 8 for a discussion of the benefit corporation.
180. See Bishop, supra note 38, at 2.
designation will appear that focuses more on the mission than on PRIs. A third possibility, of course, is that the L3C concept is broad enough to include both groups. If the proposed federal legislation\footnote{Philanthropic Facilitation Act, supra note 36.} is passed, those who are interested in PRIs will proceed through the voluntary process of receiving the IRS imprimatur, because foundations are less likely to offer PRIs without it. Those who are uninterested or not yet ready for PRIs will be able to decide for themselves whether to take the steps necessary to obtain IRS recognition. If they do not take those steps, they will remain state-designated L3Cs, much as nonprofit corporations that do not become 501(c)(3) organizations remain nonprofit corporations in their states of incorporation\footnote{The enforcement mechanisms may ultimately be different for the L3Cs that receive PRIs than for those that do not, given the difference between state and federal jurisdictions. The enforcement criteria may also be different because states will not have the same concern about misuse of tax-deductible funds as the IRS will. Continuing the parallel between nonprofit corporations and 501(c)(3)s, the states may be more interested in governance and the low-profit message of the L3Cs, while the IRS will ensure that foundations’ funds are used appropriately.} Again, it is too early to resolve this issue, but it is an issue that should be considered as the L3C concept and other forms of social enterprise evolve.

E. Can this Study Inform the Discussion about Appropriate Enforcement Mechanisms for the L3C?

This study also raises questions about the appropriate enforcement mechanisms for the L3C. Critics of the L3C maintain that unscrupulous actors will take advantage of the state statutes’ failure to establish a mechanism to monitor whether an L3C meets the required charitable and educational purposes or whether it continues to place its social purpose above the profit motive.\footnote{Cohen, supra note 48; Brakman Reiser, supra note 8, at 650.}

As described in Part III, the L3Cs that participated in this study all have noble missions and probably meet the “charitable and educational” requirements of the statute.\footnote{VT. STAT. ANN. tit. 11, § 3001(27) (2010).} The list of purposes in § 170(c)(2)(B) is identical to those listed in § 501(c)(3),\footnote{See supra note 12 and accompanying text.} and almost every organization that applies for recognition as a 501(c)(3) receives its letter of determination.\footnote{See ROB REICH ET AL., ANYTHING GOES: APPROVAL OF NONPROFIT STATUS BY THE IRS 10 (2009), available at http://www.stanford.edu/group/reichresearch/cgi-bin/site/wp-content/uploads/2009/11/Anything-Goes-PACS-11-09.pdf (maintaining that 99% of all applications are approved).} In all probability, the L3C organizations responding to the survey would be...
able to state their purposes in such a way that they would fulfill the § 170(c)(2)(B) requirements.

Nevertheless, no mechanism exists to determine whether they actually do fulfill these requirements. The Vermont Secretary of State allows any organization that checks a box on the Limited Liability Companies Articles of Organization form\(^{187}\) stating that it is an L3C to become an L3C so long as the fee is included with the form.\(^{188}\) Nowhere on this form is there a list of the permissible purposes, and the founder of the L3C is not asked to include a statement that the organization meets the requirements of the statute.\(^{189}\) Although the proposed federal statute would create a system that vets the missions of these organizations and determines whether they are capable of accepting a PRI, such a system has not been implemented.\(^{190}\)

Two findings from the survey could raise additional concerns about whether the charitable and educational requirements are met. First, several of the L3C adopters did not use attorneys when they began their organizations.\(^{191}\) Even if these entrepreneurs had read the Vermont statute, a layman’s definition of “charitable” and “educational” could be different from a lawyer’s. Second, only some of the organizations had written policies in place to help ensure that the mission would remain paramount.\(^{192}\)

Other findings, however, are more reassuring. Even those who did not use an attorney when setting up their L3Cs reported a high degree of awareness of the statutory requirements.\(^{193}\) Also, the more complex

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188. See supra note 125.
189. Id.
190. See supra note 41 and accompanying text.
191. L3Cs labeled 3, 6, 7, 8, 13, 24 and 25 mentioned that they had not used attorneys when starting the L3C, although L3C labeled 4 used one for the operating agreement. L3Cs labeled 1, 2, 9, 11, 14, 16, 17, 19, 20, 27, and 28 said they did use attorneys. The others did not respond to this question.
192. The lack of policies requiring the mission to be paramount may not be as alarming as seems at first blush. Those organizations that are already affiliated with a 501(c)(3) organization tend to have both an operating agreement and a written policy protecting the mission. Without such an agreement, the 501(c)(3) could have its own tax problems. The organizations that receive angel investments are also likely to have something in writing about the mission, but it is less clear that the investors will enforce this part of the agreement without the tax incentive to do so. The remaining organizations are single-member organizations, for whom the mission is more likely to stay paramount than if the organization were more complex. Nevertheless, policies are no substitute for an enforcement mechanism.
193. All ten respondents to the second survey reported being very aware that the L3C’s purpose “must significantly further the accomplishment of one or more charitable or educational purposes, as defined in § 170(c)(2)(B) of the Internal Revenue Code of 1986, and the L3C would not have formed except for its relationship to the accomplishment of this/these charitable or educational purpose(s).” Nine of the ten were very aware that “no significant purpose can be the production of income or the appreciation of property,” and nine of the ten were also very aware that “there can be no political or
organizations, those that might need a policy to protect their mission, are the ones most likely to have one. Those without policies protecting the mission tend to be the smaller, single-member L3Cs for which a policy would only remind the founder of the mission. No amount of lawyers or policies, however, can substitute for an enforcement mechanism.

The L3C architects and promoters have two answers to the concerns about defining and monitoring the purposes of the L3Cs. One is that the federal legislation will address many of these concerns, because the IRS will determine which organizations actually qualify as L3Cs. The second is that, even without federal legislation, the private foundation investors will enforce the social mission. Theoretically, the foundations will receive the lowest financial return but maintain a significant governance presence, which will give the foundations enough control over the company to enforce the mission. The foundations’ incentive to maintain this mission is built-in, for the tax consequences to the private foundation are too large for it to make a PRI to an entity that has never had or has lost its charitable or educational mission.

These answers are only partially reassuring, however. The federal legislation has not been enacted, and there is no guarantee it ever will be. Even if it is enacted, the determination will be voluntary. Thus, L3Cs that do not seek the federal designation or receive PRIs will not be covered by either of the above-described enforcement mechanisms. Nevertheless, passage of the federal legislation should go a long way toward answering the concerns of those who fear that tax-exempt funds from foundations will be used to enrich entrepreneurs.

Protecting the public fisc is not the only policy concern, however. Policy-makers will want to protect investors, customers, and even the L3C brand itself from misuse. The first well-publicized abuse of these terms will harm the entire social enterprise movement along with its victims. The temptation to regulate will be strong, and the desire to prevent such abuse before it happens is understandable.

Legislators and government officials grappling with these issues should keep in mind the dangers of too much regulation. Every one of the social

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194. See supra note 63 and accompanying text.
195. See supra note 40 and accompanying text; Brakman Reiser, supra note 8, at 646–47.
196. Brakman Reiser, supra note 8, at 651.
197. Id. at 628–29.
198. Bishop, supra note 22, at 244.
199. Philanthropic Facilitation Act, supra note 36, at 8.
200. See supra notes 41–45 and accompanying text. The legislation should also go a long way toward reassuring foundations.
entrepreneurs in this study had an idea that fit within the 501(c)(3) model, and every one of them decided to forego tax exemption and tax-deductible contributions in order to avoid the complex rules and regulations that accompany the 501(c)(3).\textsuperscript{201} As one respondent noted, “The whole sector is set up to discourage entrepreneurship.”\textsuperscript{202} Too much regulation can stifle the social creativity we will need if we hope to encourage new approaches to solving problems.

Given that the statutory language authorizing the L3C parallels language in the federal tax code relating to private foundations, the danger that this new entity will quickly become as complicated as the 501(c)(3) is genuine. At that point, the L3C will no longer be useful to the entrepreneurs who seek a simple business form that proclaims a social mission. Policy-makers who hope to see social enterprise help solve our society’s problems will need to keep these concerns in mind as they work to prevent abuse, for the wheels of social enterprise will undoubtedly run more smoothly if the brakes are not constantly engaged.

CONCLUSION

The early adopters of the L3C have created enterprises that try to solve a wide range of problems. What they have in common is a seemingly genuine interest in improving the world through a business entity that provides them with simplicity, control, and the ability to signal their social mission through the L3C. In other words, they are looking for a “for-profit with a nonprofit soul.” The early adopters are less interested in receiving PRIs, however, a finding that appears to contradict the expectations of the L3C’s creators.

These findings lead to several questions that policy makers should consider as they decide whether to adopt or revise L3C legislation and what regulations to impose. Is the emphasis on PRIs misplaced? Should entrepreneurs who are not interested in PRIs find another business entity through which to advance their mission? What level of regulation is necessary? These questions cannot be resolved at this early stage, because the L3C is a new and relatively untested idea, and much will change if the concept gains traction.

Whatever happens, an observation from Bill Dunnington, Managing Partner of Virginia Energy Project, will remain true. When asked his opinion of the L3C, he wrote, “A new type of organization is trying to be

\textsuperscript{201} See supra notes 118–25 and accompanying text.
\textsuperscript{202} L3C labeled 15.
born because governments and businesses are both failing in critical institutional aspects. "It's fundamentally a values issue trying to surface in governance and structural ways." Whether the L3C concept takes off, evolves, or even disappears over the next few years, it has given these pioneers an institutional outlet for their values—a for-profit with a nonprofit soul.

203. E-mail from Bill Dunnington, Managing Dir., Va. Energy Project, to author (July 13, 2010 06:42 EDT).
## APPENDIX A

<table>
<thead>
<tr>
<th>L3C</th>
<th>Contact</th>
<th>State</th>
<th>Business Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>CF Operations, L3C</td>
<td>Judy Geer</td>
<td>VT</td>
<td>Outdoor center to promote lifelong sports, sustainability and the environment.</td>
</tr>
<tr>
<td>CF Real Estate Holding, L3C</td>
<td>Judy Geer</td>
<td>VT</td>
<td>Real estate holding company for outdoor center.</td>
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<tr>
<td>Community Energy Exchange, L3C</td>
<td>Noah Pollock</td>
<td>VT</td>
<td>Online platform that allows community members to finance local clean energy projects.</td>
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<tr>
<td>Community Health Development Ventures, L3C</td>
<td>James Reeb</td>
<td>PA</td>
<td>Provider of low cost unregulated capital to fund health care facilities serving the uninsured and underinsured.</td>
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<tr>
<td>Energy Conservation Services, L3C</td>
<td>Konrad Schletema</td>
<td>VT</td>
<td>Consortium offering renewable energy and conservation solutions.</td>
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<tr>
<td>ErgTrax, L3C</td>
<td>Janet Evanczuk</td>
<td>VT</td>
<td>Online consumer education about maximizing the efficiency of local energy resources.</td>
</tr>
<tr>
<td>Green Omega, L3C</td>
<td>Jon Kidde</td>
<td>VT</td>
<td>Consultant to governmental and socially beneficial organizations, guided by restorative justice principles.</td>
</tr>
<tr>
<td>H20, L3C</td>
<td>Michael Harp</td>
<td>NJ</td>
<td>Community development organization, focusing on health, education, human services, and environment related opportunities</td>
</tr>
<tr>
<td>Institute for Public Financial Incentives, L3C</td>
<td>Matthew Rudicoff</td>
<td>NY</td>
<td>Educator and consultant on the acquisition and use of public financial incentives.</td>
</tr>
<tr>
<td>Institute for Interdisciplinary Innovation</td>
<td>Jason L. Outlaw</td>
<td>MA</td>
<td>Organization bringing together people from various disciplines to find creative solutions to problems.</td>
</tr>
<tr>
<td>Name</td>
<td>Founder(s)</td>
<td>Location</td>
<td>Description</td>
</tr>
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<td>---------------------</td>
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<td>-----------------------------------------------------------------------------</td>
</tr>
<tr>
<td>interSector Partners, L3C</td>
<td>Rick Zwetsch</td>
<td>CO</td>
<td>Organization providing education and consulting that encourages the business, nonprofit and governmental sectors to collaborate to find a combined social, economic, and environmental bottom line.</td>
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<td>ISC Enterprises, L3C</td>
<td>Brendan Keleher</td>
<td>VT</td>
<td>Environmental education in China.</td>
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<td>J &amp; J Motorcycle Safety</td>
<td>Joann H. Long Ignaszewski</td>
<td>VT</td>
<td>Motorcycle safety education</td>
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<td>L3C Advisors, L3C</td>
<td>Bob Lang</td>
<td>NY</td>
<td>Organization educating others about L3C concept.</td>
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<td>Lit Drift, L3C</td>
<td>Julia Evanczuk</td>
<td>NY</td>
<td>Online resource dedicated to storytelling.</td>
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<td>Maine's Own Organic Milk Company</td>
<td>Bill Eldridge</td>
<td>VT</td>
<td>Producer, processor, marketer and distributor of organic milk.</td>
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<td>Milton Youth Lacrosse</td>
<td>Mark M. Baker</td>
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<td>Fundraising arm of youth sports organization.</td>
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<td>National Sports &amp; Entertainment Law Society</td>
<td>Andrew Delaney</td>
<td>VT</td>
<td>Umbrella group for student sports and entertainment law societies.</td>
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<td>ParentRise, L3C</td>
<td>Loretta Maase</td>
<td>TX</td>
<td>Website serving as a comprehensive resource for single parents.</td>
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<td>Philanthropic Multiplier Fund</td>
<td>Dan Pallotta</td>
<td>MA</td>
<td>Fundraising support organization.</td>
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<td>Radiant Hen Publishing</td>
<td>Tanya Sousa</td>
<td>VT</td>
<td>Children's book publisher, with books on sustainable/humane agriculture, ecology, Vermont people and places, and kindness to all living things.</td>
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<td>Rbods.com</td>
<td>Robert Hart</td>
<td>CA</td>
<td>Community platform that focused on healthy living, routine exercise and preventative medicine.</td>
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<tr>
<td>Safer Pediatric Imaging</td>
<td>Mark Benz</td>
<td>VT</td>
<td>Research organization devoted to improving CT scan safety through better x-ray technology.</td>
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<tr>
<td><strong>Sustainable Timber Investment Exchange</strong></td>
<td>Eli Gould</td>
<td>VT</td>
<td>Timber harvesting company that uses sustainable and ecological harvesting techniques.</td>
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<td>------------------------------------------</td>
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<tr>
<td>The Farm at South Village</td>
<td>Will Raap</td>
<td>VT</td>
<td>Community based organic farm.</td>
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<td>Vermont Solar Farm L3C</td>
<td>H. Kenneth Merritt Jr.</td>
<td>VT</td>
<td>Organization building infrastructures to provide energy systems for homes and businesses.</td>
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<tr>
<td>Virginia Energy Project</td>
<td>Bill Dunnington</td>
<td>VA</td>
<td>Public/private initiative designed to increase energy conservation, efficiency and renewable generation initiatives in Virginia.</td>
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<tr>
<td>Zirgoflex</td>
<td>Maureen Doyle</td>
<td>VT</td>
<td>Technology resource for online art museum.</td>
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APPENDIX B: QUESTIONS ASKED OF ENTREPRENEURS

I. SURVEY OF VERMONT’S L3C PIONEERS

--Sept. 18, 2009 via letter and online

INTRODUCTION

Thank you for taking the time to complete this survey of L3Cs that have registered in Vermont. I am hoping to learn why entrepreneurs choose this new business form and what we can learn from early adopters. If you have questions, please contact me at bschmidt@vermontlaw.edu.

Please either mail this survey by February 5 to Betsy Schmidt, Vermont Law School, 164 Chelsea Street, POB 96, South Royalton, VT 05068, or take the survey online at http://www.surveymonkey.com/s.aspx?sm=IUqbkKTK3XRWe1HKxpz1Tg_3d_3d.

Best regards,
Betsy Schmidt

Questions

1. Please provide:

Your Name:__________________________________________________

Name of L3C:_________________________________________________

Address:_____________________________________________________

City/Town: _________________ State: __________

ZIP: __________

Email Address: _________________ Phone: _________________
2. What is the purpose of your L3C?

________________________________________________________
________________________________________________________

3. Which classification(s) fits your L3C?

_______ Environment          ________ Historic preservation
_______ Arts education        ________ Community improvement
_______ Education             ________ Socially-beneficial publishing
_______ Performing arts       ________ Animal welfare
_______ Anti-poverty           ________ Protection against abuse
_______ Health                ________ Reducing, preventing, or rehabilitating crime
_______ Faith-based           ________ Housing assistance
_______ Social Consulting     ________ Socially-beneficial technology
_______ Agricultural          ________ Other (please specify)

4. Why did you choose the L3C form for your organization? Choose all that apply.

_______ Wanted the "halo effect" from a social organization
_______ Wanted more control than is possible in a nonprofit organization
_______ Did not want to worry about unrelated business income or commercialization
_______ Hope to receive PRI money from foundations
Realized that profits alone were not the motivation for this enterprise  

Wanted protection from liability without the complexities of a corporation  

Wanted to be on the cutting edge  

My lawyer told me this would be the best form for the enterprise  

I have no idea why  

Other (please specify)  

5. Now that you have had some time to get your business going, do you have a different perspective on the advantages and disadvantages of using the L3C business form to accomplish your social and business purposes? If so, please explain how your views have changed.

Yes
No

If you answered yes, please explain how your views have changed and why

6. Do you still believe the L3C is the best business form for your venture?

Yes
No

Please explain why or why not

7. Which of the following applies to your organization? Please answer all that apply.

This is a single member organization.

The L3C has two or more members, but all have the same classification.

The L3C has different membership classifications.

The L3C has a membership agreement.
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<tr>
<td></td>
<td>The L3C is member managed.</td>
<td>The L3C is manager managed.</td>
<td>The L3C is not yet operational.</td>
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<td>The L3C is no longer in business.</td>
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8. Do you have any policies, procedures, contracts, or other arrangements that are designed to safeguard your social mission?

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<td>Yes</td>
<td>No</td>
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If so, please explain

________________________________________________________________________________________

________________________________________________________________________________________

9. Would you be willing to share your membership agreement with the author of this survey?

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<tr>
<td>Yes</td>
<td>No</td>
<td>Not applicable</td>
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10. Would you be willing to speak with the author of this survey on the phone so that she can learn more about your organization, its operations, and your thoughts about the strengths and weaknesses of the L3C form for your business organization?

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<td>Yes</td>
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If your answer is yes, please be sure you have included your email address so that I can use email to set up an appointment to speak with you.
II. Survey of Vermont’s L3C Pioneers (2)

--Conducted June 27, 2010 online

INTRODUCTION:

Thank you for responding to this follow-up survey to the original survey I sent concerning the early adopters of the L3C business form in Vermont. I will send you a copy of the article when it is published. Feel free to call me at 757-869-0449 or email at bschmidt@vermontlaw.edu if you have any questions or if you would prefer to respond via one of these methods. Thanks, Betsy Schmidt

Questions:
1. Please provide

Your name _______________________________________________________

The name of the L3C __________________________________________

Email address ___________________ Phone _______________________

2. The original survey asked why you chose the L3C business form. It suggested several possibilities, such as legal advice; the halo effect; expected low profits; protection from liability; and the desire to receive program related investments. Which, if any, of the following additional considerations were relevant as you made a choice of a business entity?

Flexibility of the L3C ____________
Cost ________________________
The business form itself fits with the mission of the organization ______

Which of the reasons listed above (from either survey) do you consider the most important in your decision to organize your business as an L3C?
3. How has your organizational structure changed, if at all, since you completed the survey or spoke to me on the phone? For example, have you added members, signed an operational agreement, switched whether the organization is member or manager managed, or even changed from an L3C business entity to another business form?

_____________________________________________________________

_____________________________________________________________

4. How has your organization's financial situation changed, if at all, since you responded to the survey or spoke with me? For example, have you begun operations? Have you received funding from foundations or angel investors?

_____________________________________________________________

_____________________________________________________________

5. Are you still satisfied with your decision to organize as an L3C?
   Yes _____
   No _____

Please explain why

_____________________________________________________________

6. Did you use an attorney when you set up the L3C?
   Yes ______
   No _______

7. At the time the L3C was organized, how aware were you of the specific requirements of the L3C legislation that:

   A. The L3C's purpose must significantly further the accomplishment of one or more charitable or educational purposes, as defined in § 170(c)(2)(B) of the Internal Revenue Code of 1986, and the L3C would not have formed except for its relationship to the accomplishment of this/these charitable or educational purpose(s);

      Very     Somewhat     Kind of     Not really     Not at all

   B. No significant purpose can be the production of income or the appreciation of property;

      Very     Somewhat     Kind of     Not really     Not at all
C. No significant purpose can be the production of income or the appreciation of property

| Very | Somewhat | Kind of | Not really | Not at all |

Please explain how you adjusted to these requirements, if at all, or how you would have adjusted, if at all, had you been aware of them.

________________________________________________________________________

8. Is your L3C a start-up organization?
Yes ______
No ______
If so, is it operational yet? ______

9. Is your organization affiliated with any other type of business entities?
A corporation ______
A limited liability company ______
A 501(c)(3) tax exempt organization ______
Another nonprofit organization ______
If so, please explain the relationship__________________________________________
III. TELEPHONE INTERVIEW QUESTIONS

--Conducted Oct. 2009-June 2011

Identifying information—name, L3C name, etc.

1. What type of business are you engaged in?

2. What is your social mission/purpose?

3. How did you learn about the L3C?

4. Why did you choose L3C? Please prioritize the reasons?

5. Did you consider an alternative business form? An LLC? A 501(c)(3)? If so, why did you choose the L3C over the alternative(s)?

6. Have you tried to obtain a program related investment?

7. How do you plan to capitalize your venture?

8. Has the L3C met your expectations? Why do you respond this way?

9. Do you have a written agreement or policy to ensure the social mission remains the most important part of your enterprise?

10. What do you see as the strengths and weaknesses of the L3C form for your business?

11. Was forming as an L3C the right decision for your organization?