



interSector Partners, L<sup>3</sup>C  
What's *your* bottom line?

## **How-to: An Insider's Look at the L3C and What it Could Mean For You and Your Social Enterprise**

There's been a fair amount written about the L3C recently. We're seeing the gamut from people over-the-top excited about the possibilities of this innovative, hybrid business model to pundits dismissing the L3C as a mediocre solution to anything at best.

Some of what we hear and read is true, some partially true and some not true at all. Generally, we are seeing social entrepreneurs trying to harness the excitement while academics research and analyze. Not entirely unexpected!

We hear what we want to hear, believe what we want to believe and that becomes our reality. Much of what is being written, spoken and tweeted about is what people "want" to believe. The L3C is an exciting new concept bringing together two worlds that have long needed to collaborate and make big things and good things happen together! When new ideas are born that are believable and have the potential to create immediate, long-lasting change – sometimes our enthusiasm kicks into overdrive and we don't get all the facts just right.

All the intricacies and details of the L3C including business structure, tax and financial issues are beyond the scope of this brief introduction to the L3C. I'm here to provide a general overview of some of the important facts and issues to consider as you decide if the L3C is right for you. Please understand there are a potentially infinite number of scenarios where the L3C will not work, where the L3C is not the right business structure, where the L3C just doesn't make sense and therefore just won't fit.

**The bottom line:** We're interested in talking with, educating and working with social entrepreneurs, who want to research, brainstorm, create, nurture and grow scenarios that turn into enterprises where the L3C WILL work. Social entrepreneurs who are passionate about being agents for positive social change. We want to empower social purpose businesses, foundations and all others concerned with a focused pursuit of enhancements and improvements to our society.

### **Why the L3C and why now?**

There are many reasons but here are just a few: Experts are predicting that with the current economic environment eating away at nonprofit's primary sources of funding (charitable donations and foundation funding), that as many as 100,000 of the nations roughly one million nonprofit organizations will close their doors in 2009. This is a scary reality.

Current social purpose businesses are reeling from the crisis in the capital and credit markets. Traditional funding sources aren't quite sure what to make of a business that puts social purpose BEFORE profit.

Foundations are making fewer grants and smaller grants because their investment/endowment portfolios have not been able to withstand the current economic turmoil.

Nonprofits need to start behaving more like businesses. For-profits businesses need to start behaving more like nonprofits. Nonprofits and for-profits need to start working together.

**The bottom line:** All this is a fairly tenuous backdrop to what we feel is a very positive and uplifting opportunity that comes along with a complete and accurate understanding of the L3C.

### **What is an L3C?**

Very simply and according to its creator Robert Lang, the L3C is not a nonprofit. It is a for profit venture that under its state charter must have a primary goal of performing a socially beneficial purpose not maximizing income. The legislation was specifically written to dovetail with the federal IRS regulations relevant to Program Related Investments (PRIs) by foundations. The L3C facilitates PRI investment without the need for IRS private letter rulings. Further, because the foundations take the highest risk at little or no return, it essentially turns the venture capital model on its head and gives many social enterprises a low enough cost of capital that they are able to be self sustainable.

Mr. Lang goes on to state; the L3C was built on the LLC structure in order to provide the flexibility of membership and organization needed to cover a wide variety of social enterprise situations. It also makes it very easy for lawyers and laymen alike to grasp since it does not create a new structure but merely amends the definition section of the LLC acts in most states. That leaves 15+ years of legislation and litigation that is behind the LLC intact behind the L3C.

**The bottom line:** We believe this to be one of the important, if not the most important consideration for the L3C business model – the potential for social entrepreneurs to gain access to new, creative, more available, more favorable sources of funding to launch and/or grow a social enterprise.

### **How do you form an L3C?**

As of August 7<sup>th</sup>, L3C legislation, basically amending a state's LLC statutes, has been signed into law in Vermont, Michigan, Wyoming, Utah, Maine (*effective 9-12-09*) and Illinois (*effective 1-1-10*) as well as the Crow Indian Nation and the Oglala Sioux Tribe. Legislation is currently [being discussed and pending](#) in several other states.

The L3C is recognized in all 50 states as it is a variant form of LLC and every state must honor and recognize every other state's LLCs - just as you can form a Delaware corporation and do business in Idaho, Colorado, North Carolina or any state in the U.S.

Today, the process for forming an L3C is actually quite simple. While each state's requirements vary slightly, social entrepreneurs wishing to form an L3C will file Articles of Organization with the appropriate state regulatory authority in one of the six states listed above and pay the required fee. Our company, interSector Partners, L3C, filed Articles of Organization with the Vermont Secretary of State and paid a \$100 fee. We chose Vermont, first, because they were the first state to pass L3C legislation and second, because the Vermont LLC statutes are very similar to the LLC statutes in Colorado. But we could have organized in any state that has passed L3C legislation at that time.

Our next step, as we are based in Colorado, was to register as a foreign entity doing business in Colorado. It's a simple three page form and a \$125 fee. If we open offices in other states, we'll need to register as a foreign entity in those states as well, in accordance with those state's statutes and laws.

**The bottom line:** the process to form an L3C is generally quite simple and not at all time consuming.

#### **Other things to consider:**

- The L3C, just like the LLC, is a for-profit business structure. While some call it a “low profit limited liability company” you'll need to earn and retain profit to sustain your business over the long-term.
- Should you obtain PRI from a foundation, you'll need a viable and sustainable revenue model to pay back the PRI plus interest, if applicable.
- Right now, there is no “low profit” police. No one will be watching over your shoulder deciding how much profit is too much profit. Ultimately, social purpose is your guiding star and if you'll have to answer to anyone, regarding profit, it may be those that that your L3C serves.
- After organizing your L3C, you'll need to draft your operating agreement. Just like with an LLC, the operating agreement is the governing document of the business. While, as of this date, there are no official “filing” requirements, the L3C's operating agreement generally must be made available for inspection. We also believe, that in the interest of transparency, we should probably anticipate future filing requirements regarding some portion or all of an L3C's operating agreement.
- Before approaching a foundation for PRI or approaching other funding sources such as community financial institutions or angel investors, you'll need to prepare a business plan – just as you would if your business was an LLC, C or Sub S corporation.
- As you explore whether an L3C is the right business structure for your social enterprise – make certain to engage the services of qualified legal, accounting, tax, financial and other professional counsel as your particular situation dictates.

## So, which legal structure is right for your social enterprise?

This can be a complicated question and will depend on your particular situation. We highly recommend you review [Effective Social Enterprise — A Menu of Legal Structures](#) by Robert A. Wexler for an in-depth discussion of the various different legal structures as they relate to social enterprise.

### The L3C in action:

The L3C is so new; there are no real illustrative case studies. As of this writing, there are 75 registered L3Cs in the US – some of which we are certain are not yet truly in business. There are a couple of very interesting L3Cs getting ready to hatch. [You can read brief summaries here.](#)

### Hurdles:

There are a few key hurdles you'll have to get over if you're seriously considering the L3C for your social enterprise:

- While nearly all foundations are aware of PRI, only a very small percentage actually make PRI. The record shows us it's larger foundations making PRI in larger projects. This may affect your ability to attract PRI for your L3C. We're working diligently to shorten the foundation learning curve.
- The IRS has not "blessed" the L3C. This is not really so important for the L3C but rather for the foundations making PRI into an L3C. This may affect your ability to attract PRI for your L3C.
- While individual states are amending their LLC statutes to allow for the L3C, as of this writing, there is no Federal L3C legislation. The creator of the L3C, Robert Lang and his team, are introducing Federal legislation but it's much too early to tell its final outcome or effect. This may affect your ability to attract PRI for your L3C.

**The bottom line:** These are by no means all the hurdles. The L3C is new and basically untested. Everyone's on the learning curve. For some that learning curve will be steeper than for others.

Everything about the L3C brings to mind a saying our good friend and attorney Marc Lane reminds us of: *No one wants to be a pioneer, but no one wants to be left behind.* For those with a pioneering spirit, we believe the L3C experience will be fruitful and the rewards will be many.

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*This article addresses legal, accounting and financial matters, but does not in any way provide or constitute legal, accounting or financial advice or opinion. It is strongly recommended that all readers consult their individual professional legal, accounting and financial advisors and take action only upon receipt of such advice. Neither the author nor interSector Partners, L3C endorse the L3C business structure and assume no responsibility or liability for actions taken or not taken as a result of the information contained herein.*

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With nearly 30 years of business marketing and advertising experience under his belt, Rick knew there had to be a way to combine social good with profit motives. With a focus on market-based results, Rick is a co-founder and principal partner in the firm [interSector Partners, L3C](#) based in Boulder County, Colorado. The firm provides education and consulting services to help nonprofits become more sustainable, for-profits become more socially responsible and government agencies to better support both in their community. The firm also consults with social entrepreneurs interested in the L3C business model.