FILLING THE GAP:
ADDRESSING THE POTENTIAL IMPACT OF
NORTH DAKOTA ADOPTING LEGISLATION CREATING
A NEW ENTITY—
THE LOW PROFIT LIMITED LIABILITY COMPANY

ABSTRACT

This article demonstrates that North Dakota law should be amended to bridge the gap between for-profit and nonprofit organizations by recognizing the low profit limited liability company. Part II of this article analyzes the flaws surrounding the current business sector and nonprofit sector and discusses why there is a need for hybridization. This discussion includes a review of a for-profit’s duty to maximize profits and nonprofits’ limited access to capital and spending regulations. Part III of this article explains the low profit limited liability company structure and examines the new entity’s uses or proposed uses in other states. Finally, part IV describes the specific changes necessary to introduce the low profit limited liability company into North Dakota law and discusses why the North Dakota Legislature should adopt the legislation originally proposed to the Sixty-first Legislative Assembly in 2009.
I. INTRODUCTION

In a 2007 commencement speech, Bill Gates challenged Harvard graduates to develop a more creative capitalism.1 He sought to persuade the graduates to “stretch the reach of market forces so that more people can make a profit, or at least make a living, serving people who are suffering from the worst inequities.”2 Challenging one to make a profit while

2. Id.
achieving a social mission is no small task under today’s legal system. Organizational structures do not facilitate the overlap of social benefits and profit-making because there is a divided three sector system: business, nonprofit, and government. Many critics believe the gap between the for-profit entities and the nonprofit entities can be exploited to create a fourth sector. A hybrid social enterprise organization is one arguable solution to utilize the fourth sector. Although there are several proposed hybrid structures, one in particular provides a great deal of promise: the low profit limited liability company. The low profit limited liability company, known as the L3C, has been described as a for-profit entity with a nonprofit soul. With the hopes of positive social benefits on the horizon, the L3C “appears to be the tool best adapted to give legal standing and structure to its hybrid social enterprises.”

In 2009, a bill was introduced to the North Dakota Legislature that would have effectively created the statutory structure necessary to form an L3C. After the legislature discovered more questions than answers, House Bill 1545 was amended “to provide for a legislative council study relating to the feasibility and desirability of creating . . . [the] low-profit limited liability company.” The amended bill was passed on April 8, 2009, and the findings and recommendations were to be reported back to the Sixty-Second Legislative Assembly in 2011.

This article demonstrates North Dakota law should be amended to bridge the gap between for-profit and nonprofit organizations by recognizing the L3C. Part II of this article discusses the for-profit and nonprofit sectors by examining the flaws in our current legal system and why

---

3. See infra Part II.A-B (describing the issues that make it difficult to reconcile the for-profit bottom line with the nonprofit bottom line).
5. Id.
6. Id. at 339.
7. Id. at 342.
11. Id. (as passed by House, Feb. 5, 2009).
12. Id. (enacted).
13. See infra Part IV.B (explaining how the L3C could stretch North Dakota foundations’ qualifying distributions to reach more people and how the L3C could potentially bring more capital into North Dakota to serve a social purpose).
there is a need for hybridization. Part III explains the L3C structure and examines the L3C’s uses or proposed uses in other states. Lastly, Part IV describes the specific changes necessary to introduce the L3C into North Dakota law and discusses why the North Dakota Legislature should adopt the legislation originally proposed to the Sixty-First Legislative Assembly on January 19, 2009.

North Dakota’s current legal structure draws a line between for-profit entities and nonprofit entities. The following section analyzes the issues raised as a result of the divided for-profit and nonprofit sectors. Part II specifically discusses how these issues negatively impact growth in businesses driven by a social mission.

II. THE CURRENT THREE SECTOR LEGAL SYSTEM AND THE NEED FOR HYBRIDIZATION

Under North Dakota law, corporations or limited liability companies may be formed as for-profit entities or nonprofit entities. It is the desire to operate between these two entities that has sparked the development of hybrid organizations. An inability to form a hybrid structure forces an individual to choose between a financial bottom line and a social bottom line. This section explores the polarized financial and social bottom lines the hybrid organizations seek to join. The section begins by focusing on the conflict between an entity’s fiduciary responsibilities and its desire to further a social mission. Section B examines specific problems faced by

14. See infra Part II.A-B (evaluating the conflicting ideals of maximizing profit and achieving a social purpose and discussing the hardships of forming a nonprofit organization).
15. See infra Part III.A-B (describing the L3C structure, its functions, and benefits, and examining how it has been used in Vermont, Illinois, and the Crow Indian Nation).
16. See infra Part IV.A-B (suggesting an amendment to the North Dakota Limited Liability Act and noting how the changes could potentially affect the State of North Dakota).
17. Compare N.D. CENT. CODE § 10-19.1-01(16) (2009) (defining corporation), and § 10-32-02(38) (defining limited liability company), with § 10-33-01(9) (defining nonprofit corporation), and § 10-36-02(2) (defining nonprofit limited liability company).
18. See infra Part II.A-B (analyzing how the current legal structure inhibits certain for-profit ventures from accomplishing a social aim and inhibits certain nonprofits from gaining access to capital).
19. See infra Part II.A-B (discussing how the different ideals of the for-profit and nonprofit sectors create an underinvested class of business that provides a social benefit).
20. See N.D. CENT CODE §§ 10-19.1-01, 10-32-02(38), 10-33-01(9), 10-36-02(2).
21. See Michael D. Gottesman, From Cobblestones to Pavement: The Legal Road Forward for the Creation of Hybrid Social Organizations, 26 YALE L. & POL’Y REV. 345, 345 (2007) (stating the for-profit and nonprofit sectors are recently attempting to “converge upon the middle ground”).
22. See Kelley, supra note 4, at 339-40.
23. See infra Part II.A (explaining that the duty of loyalty owed to the interest holders of the business makes the maximization of profits the predominant business purpose).
service organizations and grant-making foundations as a result of organizing as a nonprofit.24

A. FOR-PROFIT’S DUTY TO MAXIMIZE PROFIT

Most for-profit structures have a primary goal of accumulating as much profit as they can for those holding an interest in the entity.25 Success is measured on the return of the investment as opposed to an entity’s social benefit.26 A conflict arises, however, when the business wants to pursue a social mission.27 The issues become whether an entity’s obligation to maximize the interest holders’ profit restricts the business’s direction and whether there is a disincentive to engage in socially beneficial activities.

*Dodge v. Ford Motor Co.*,28 a 1919 Michigan Supreme Court decision, provides a prime example of how the for-profit structure limits an entity’s ability to pursue a social mission.29 In *Dodge*, Henry Ford sought to reduce the price of his cars by eighty dollars, which, in turn, reduced Ford Motor Company’s annual profit by $48,000,000.30 Ford further stated his ambition was “to employ still more men, to spread benefits of this industrial system to the greatest possible number, [and] to help them build up their lives and their homes.”31 The plaintiffs contended Henry Ford was running Ford Motor Company as a “semi-eleemosynary institution”32 as opposed to a “business institution.”33 The court concluded a “business corporation is organized and carried on primarily for the profit of the stockholders.”34 Thus, Ford’s ability to provide a social benefit to others was limited by the corporation’s bottom line, the obligation to maximize profit for the shareholders.35

---

24. See infra Part II.B (explaining that service organizations are unable to achieve significant profits and investments and that grant-making foundations’ spending is regulated to only exempt purposes).


26. See Kelley, supra note 4, at 362 (citing ALLEN R. BROMBERGER, SOCIAL ENTERPRISE: A LAWYER’S PERSPECTIVE 5 (2007)).

27. Gottesman, supra note 21, at 351.


29. Gottesman, supra note 21, at 350 n.21 (citing Dodge, 170 N.W. at 683).


31. Id.


34. Id. at 684.

35. See id.
The fear of being sued for failing to maximize profits and for breaching one’s duty of loyalty clearly creates a disincentive to engage in socially beneficial activities with an increased risk.\textsuperscript{36} Beyond the duty to maximize profits, the tax code does little to encourage for-profit ventures to engage in charitable activities.\textsuperscript{37} An individual may deduct a charitable gift up to either thirty percent or fifty percent of his taxpayer contribution base; yet, a corporation may only deduct gifts up to ten percent of its taxable income.\textsuperscript{38} Accordingly, the tax code does little to entice a business entity to achieve a charitable purpose.\textsuperscript{39}

The discussion in this section is not advocating that there is anything wrong with the legitimate motive to maximize profits. From a for-profit perspective, however, the duty to maximize profit, coupled with the tax code, places social goals and charitable actions at opposite ends of the business sector. Thus, the current state of business structures generates a need for an entity that can bring together the profit motive with the desire to achieve a social mission. The next section shifts the emphasis from the for-profit perspective to the nonprofit perspective.

B. VIEWING THE GAP FROM THE NONPROFIT PERSPECTIVE

At the same time, nonprofit organizations also face challenges that hybridization seeks to redress.\textsuperscript{40} Whereas a for-profit entity’s primary focus is the maximization of profit, a nonprofit’s focus is purely on charitable goals and a social mission.\textsuperscript{41} This section focuses on the gaps created in the nonprofit sector as a result of separating each sector’s bottom line.\textsuperscript{42}

There are two kinds of nonprofit organizations: (1) service organizations and (2) grant-making foundations.\textsuperscript{43} Grant-making foundations raise money and distribute that money to service organizations.\textsuperscript{44} Service organizations, in turn, spend money to support a social mission.\textsuperscript{45} Both

\begin{itemize}
  \item \textsuperscript{36} See id. at 683-84 (holding Ford Motor Co. is a business corporation whose primary purpose is to maximize profit).
  \item \textsuperscript{37} Gottesman, supra note 21, at 350-51.
  \item \textsuperscript{38} Id. at 351 n.23 (citing 26 U.S.C. §§ 170(b)(1)(A)-(B), (b)(2) (2000)).
  \item \textsuperscript{39} See id. at 351.
  \item \textsuperscript{40} Kelley, supra note 4, at 346, 353-54.
  \item \textsuperscript{41} Id. at 353 (citing Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) (2008) (“prohibiting tax-exempt public charities from distributing profits to equity investors”)) (stating that nonprofits exist to benefit the public); Revised Model Nonprofit Corp. Act §§ 1.40, 13.01 (1987) (“prohibiting payments under model state law from nonprofit corporations to their ‘members, directors, or officers’”).
  \item \textsuperscript{42} See infra Part II.B (explaining how restrictions are placed on nonprofits that prevent access to capital through profit, investors, and investing).
  \item \textsuperscript{43} Kelley, supra note 4, at 347.
  \item \textsuperscript{44} Id. at 347-48.
  \item \textsuperscript{45} Id. at 348.
\end{itemize}
grant-making foundations and service organizations, nevertheless, possess disadvantages when compared to for-profit businesses.\footnote{Id.}

Service organizations have a distinct problem gaining access to capital.\footnote{Id.}. For example, to be tax-exempt as a nonprofit, the organization “must be both organized and operated exclusively for one or more exempt purposes.”\footnote{Id. at 344 (citing 26 C.F.R. § 1.501(c)(3)-1(c)(1) (2008)).} Although engaging in socially beneficial activities is an exempt purpose, the pursuit of profit generally is not.\footnote{Id. at 345; Thomas Kelley, Rediscovering Vulgar Charity: A Historical Analysis of America’s Tangled Nonprofit Law, 73 FORDHAM L. REV. 2437, 2437-83 (2005).} Even after securing tax-exempt status, a service organization can still be taxed on profits that originated from “trade or business regularly carried out and not substantially related to the performance of an organization’s exempt purposes.”\footnote{Gottesman, supra note 21, at 348 (citing 26 U.S.C. § 513 (2000); 26 C.F.R. § 1.513-1 (2007)).} Furthermore, service organizations cannot distribute profits, and, thus, cannot raise capital by attracting investors who may be looking for a financial return.\footnote{Id.} As a result of these restrictions, service organizations have limited access to capital.\footnote{Id.}

Whereas the predominant issue with service organizations is their limited access to capital, a foundation’s overarching problem is regulated spending.\footnote{Id.} Through the fear of an excise tax, grant-making foundations are discouraged from investing “any amount in such a manner as to jeopardize the carrying out of any of its exempt purposes.”\footnote{Id. at 349 n.18 (citing I.R.C. § 4944(a)(1)-(2) (2007)).} To maintain a tax exempt status, the Internal Revenue Service (IRS) mandates most foundations and charitable trusts to make grants and/or have operating expenditures equaling at least five percent of their prior year’s average net asset value.\footnote{Robert M. Lang, Jr., The L3C: The New Way to Organize Socially Responsible and Mission Driven Organizations, SN036 A.L.I.-A.B.A. 251, 254 (2007); Jim Witkin, The L3C: A More Creative Capitalism, TRIPLE PUNDIT, Jan. 15, 2009, http://www.triplepundit.com/2009/01/the-l3c-a-more-creative-capitalism/.} Grant-making foundations, therefore, are essentially restricted to investing only in nonprofit organizations.\footnote{Gottesman, supra note 21, at 350.} However, in 1969, Congress created an exception and recognized that foundations and charitable trusts...
could meet the five percent requirement by making program related investments.57

A program related investment (PRI) is a foundation or a trust’s investment, such as purchasing an ownership interest or making a loan, in a charitable project or activity that furthers the foundation’s exempt purposes.58 A key difference is that the charitable project or activity may be a for-profit business.59 PRIs have the potential to benefit nonprofits because the investments can generate income or appreciate in value.60 On the other hand, if a foundation simply makes grants, there is no potential for the investment to generate income or appreciate in value.61

In order to qualify as a PRI, the investment must meet three requirements:

(i) the primary purpose of the investment is to accomplish one or more of the purposes described in section 170(c)(2)(B); (ii) no significant purpose of the investment is the production of income or the appreciation of property; and (iii) no purpose of the investment is to accomplish one or more of the purposes described in section 170(c)(2)(D).62

A PRI may take the form of a purchase of stock or other equity security, a low interest loan or an interest free loan, a guaranty or a letter of credit, or even a low cost lease.63 Unfortunately, nonprofits are reluctant to make PRIs because they fear the IRS will find that the investment in the for-profit

57. Rebecca H. Dent, PRI, MRI, SRI, L3C—A Short Review for Private Foundation Counsel, 19 OHIO PROB. L.J. 137, 137 (2009); Lang, supra note 55, at 254.
58. Lang, supra note 55, at 254.
59. Id.
60. The Mary Elizabeth & Gordon B. Mannweiler Foundation Inc., Presentation Workshop C-3 at the UBS Philanthropy Forum, The L3C: The For Profit with a Nonprofit Soul, (July 5, 2007), available at http://www.americansforcommunitydevelopment.org/downloads/L3CUSPresentation.pdf. Any gains on the PRI must be given away through the foundation’s usual procedures or must reinvest the PRIs within one year of receipt. Id.
61. Id.
[A] corporation, trust, or community chest, fund, or foundation ... organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals.
[A] corporation, trust, or community chest, fund, or foundation ... which is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.
63. Lang, supra note 55, at 254.
organization did not further the foundation’s goals.\footnote{64} If the investment is found not to qualify as a PRI, the nonprofit will be subject to an excise tax.\footnote{65} Moreover, the foundations have the responsibility to evaluate and monitor the organization receiving the investment.\footnote{66}

To avoid being subject to the excise tax, foundations have the option of seeking a private letter ruling from the IRS.\footnote{67} Private letter rulings, however, have proven to not only be costly, but also time consuming.\footnote{68} Private letter rulings can potentially take six to eight months to process.\footnote{69} The IRS also charges a fee of $8700, and the high legal costs and fees could rise to anywhere from $25,000 to $50,000.\footnote{70} Because of the PRIs’ uncertainty and because PRIs are characterized as cumbersome, foundations choose to make grants as opposed to investing in for-profit ventures.\footnote{71} In fact, only five percent of foundations actually designate PRIs.\footnote{72}

The for-profit and nonprofit sectors have been separated by their unique bottom lines.\footnote{73} However, separating these organizations in the current legal system limits potential social entrepreneurship that could arise if not for the limited access to capital or the duty to maximize profit.\footnote{74} There has been a recent push to cure this defect through the creation of hybrid organizations.\footnote{75} Part III not only discusses the L3C, a promising hybrid structure, but also provides information on other states using the L3C or proposing to use the L3C.\footnote{76}

\footnote{64. Gottesman, supra note 21, at 350.}
\footnote{65. Id.}
\footnote{67. Lang, supra note 55, at 254.}
\footnote{69. Lang, supra note 55, at 255.}
\footnote{70. Collins, supra note 68; Lang, supra note 55, at 255.}
\footnote{71. Witkin, supra note 55.}
\footnote{73. See supra Part II.A-B.}
\footnote{74. See supra Part II.A-B.}
\footnote{75. Gottesman, supra note 21, at 345; Kelley, supra note 4, at 339.}
\footnote{76. See infra Part III.A-B (discussing the characteristics of the L3C and observing the L3C’s adoption into laws of the State of Vermont, the State of Illinois, and the Crow Indian Nation).}
III. BRIDGING THE GAP BETWEEN THE FOR-PROFIT AND THE NONPROFIT SECTORS

In 1977, Wyoming passed the first limited liability company (LLC) legislation. After a 1988 IRS Revenue Ruling that acknowledged LLCs would be taxed as partnerships, LLC legislation swept the nation. In 1993, North Dakota embraced the new entity by passing the North Dakota Limited Liability Company Act. It would, therefore, not be extraordinary for North Dakota to follow the same path regarding an entity that could bridge the gap between for-profit and nonprofit entities if such an entity was accepted by the IRS. The following section explores the characteristics of an L3C as a hybrid organization and offers a glimpse of the L3C’s applications in other states.

A. ANALYZING THE L3C AND THE PURPOSE FOR CREATING SUCH AN ENTITY

Today’s legal system polarizes for-profit and nonprofit organizations. On the one hand, the only for-profit businesses that are attractive as investment vehicles are those with high profit returns and low risk. On the other hand, there are those businesses that do not make a profit and can only survive as a government entity or nonprofit entity. Although this observation oversimplifies today’s business environment, it illustrates the gap between for-profit entities and nonprofit entities that is underinvested. The current for-profit structure requests a higher financial return than most social mission businesses can ordinarily provide. The current nonprofit structures, meanwhile, are inhibited by their inability to gain access to capital. Consequently, it becomes difficult to bring a profit motive and a social mission together. An inability to bridge this gap discourages social innovation and

79. Id.
80. See id.
81. See infra Part III-A-B (discussing the L3C’s flexible membership structure that allows for tranching and flow-through taxation, as well as the L3C’s development in the State of Vermont, the State of Illinois, and the Crow Indian Nation).
82. See supra Part II-A-B.
83. Lang, supra note 55, at 253.
84. Id. at 253, 261.
85. Id. at 253.
86. Id.
87. Witkin, supra note 55.
inhibits investments that have an underlying social motive. This section examines the L3C structure and explains how the new entity fills the gap between the for-profit and nonprofit organizations.

Robert Lang, the Chief Executive Officer of the Mary Elizabeth & Gordon B. Mannweiler Foundation, Inc., recognized the problem discussed above and created the L3C as a possible solution. Marcus Owens, a Washington, D.C. tax attorney, furthered the idea by writing the law that created the L3C. Spun off of the LLC, the L3C is a new entity “designed to attract a wide range of investment sources thereby improving the viability of social ventures.” The L3C is a for-profit entity with a double bottom line because its primary objective is not to maximize profits, but to achieve a charitable or educational purpose. One major advantage the L3C has over the LLC is its ability to receive PRIs from private foundations without the foundation obtaining an IRS private letter ruling. Coupled with the ability to receive PRIs, the L3C retains the LLC’s flexible structure.

The L3C, like the LLC, may form flexible partnerships that allow ownership rights to be tailored to meet each partner’s requirements. The flexible membership structure allows for the creation of different classes of membership. The different classes of membership can also represent tiers

88. See supra Part II.A-B (explaining how the polarized ideals of the for-profit and nonprofit sectors leave a portion of the business sector willing to receive lower profits to achieve a social gain underinvested).
89. See infra Part III.A (explaining how the L3C’s unique characteristics allow it to have a financial and a social bottom line).
90. Lang, supra note 55, at 253. Robert Lang is an economist and a businessman. Sally Duros, How to Save Newspapers, THE HUFFINGTON POST, Feb. 9, 2009, available at http://www.huffingtonpost.com/sally-duros/how-to-save-newspapers_b_164849.html. Lang contrived the L3C structure as a way “to address the problems he was having while trying to invest family foundation money in a sustainable and effective way.” Id.
91. Witkin, supra note 55.
93. Kelley, supra note 4, at 372.
95. Witkin, supra note 55.
96. Id.
97. Kelley, supra note 4, at 374.
Social entrepreneurs could draft L3C membership agreements to create different classes of members, each with different rights and duties, and a particular member’s powers and duties would not have to correspond in any way with his or her ownership stake in the venture. It would be a straightforward drafting exercise to create a special class of members empowered to enforce the organization’s social mission. This
of capital investment. When there are different tiers of capital investment, the structure permits tranched or investment layering, where each investment layer has a tailored return and risk. The L3C takes advantage of tranched investing when a foundation invests in the equity of an L3C using the PRI. For example, the foundation takes the position of injecting capital for a very low rate of return or for no return at all because the foundations are compensated through the L3C’s social outcomes. At the same time, the foundation also takes the higher risk position. The foundation, therefore, can be subordinate to the market investors using their PRIs and absorbing the higher risk.

Next, the L3C would likely have an intermediate tier that attracts investors willing to accept below-market returns in exchange for the social benefits. Meanwhile, the last tier is geared toward the market investors seeking lower risk investments with a potential rate of return that is closer to the market rate. This last equity tier, thus, can be marketed as a safer and more lucrative investment that still enables a social benefit. Essentially, the L3C leverages a foundation’s PRIs to gain access to other investors that would not be willing to inject capital into the business without the foundation absorbing the higher risk at a below-market return. Tranched investing, therefore, gives L3Cs access to trillions of dollars from the private sector that would not otherwise be available to entities with a purely social mission. Using the L3C structure would allow either a for-profit or nonprofit organization to achieve social goals more effectively by allowing for-profits to commit to a social mission without fear of breaching

member, or members, could be a public charity or private foundation with only a minor financial stake in the venture—or none at all—but with the power to block other members from making changes to the organizational documents that would dilute its social mission.

Id.

98. Id.
99. Witkin, supra note 55.
100. The L3C: Low-Profit Limited Liability Company, supra note 92.
101. Kelley, supra note 4, at 373.
102. Id. at 374.
103. Witkin, supra note 55.
104. Kelley, supra note 4, at 374.
105. Id.
106. Id.
108. The L3C: Low-Profit Limited Liability Company, supra note 92.
a duty of loyalty and by making capital more readily accessible for nonprofits.109

Lastly, the L3C’s flexible partnership structure also permits the L3C to be taxed like an LLC, meaning the L3C would have the election to be taxed as a corporation or as a partnership.110 It would most likely be taxed as a partnership; therefore, the L3C would have profits and losses flow through the entity to the members, who would respectively file a K-1, similar to the LLC.111 The L3C, thus, results in no specialized reporting.112 The characteristics possessed by the L3C were strategically arranged to permit a double bottom line, and the next section discusses certain states that have found it a worthwhile entity to adopt.113

B. SURVEYING THE USE OF THE L3C IN OTHER STATES

The Full Faith and Credit Clause of the United States Constitution permits L3Cs organized in a state that has passed L3C legislation to be recognized in all fifty states.114 Some states across the United States are nevertheless adopting their own L3C legislation.115 One does not need to look very far to find a comparable situation; for example, LLC legislation was originally introduced in the State of Wyoming in 1977.116 By 1996, nearly all the states had passed LLC legislation.117 The first L3C legislation was passed in 2008.118 Currently, there are seven states that have passed the legislation: Vermont, Michigan, Wyoming, Utah, Illinois, Maine, and North Carolina.119

111. Id.
112. Id.
113. See infra Part III.B (describing how Vermont, Illinois, and the Crow Indian Nation have adopted the legislation).
116. Pearson, supra note 78, at 70.
118. Searing, supra note 66.
Section B examines how the L3C has been used in other jurisdictions and how some jurisdictions are proposing to use the L3C. The section begins by exploring the State of Vermont. Vermont was the first state to pass legislation introducing the L3C. This section also explores how Illinois has proposed to use the L3C. Specifically, Illinois has a unique problem with its newspaper industry. Certain individuals have turned to the L3C hoping to cure the injured newspaper industry. Lastly, this section analyzes L3C legislation passed by a body other than a state: the Crow Indian Nation. North Dakota is home to several Native American tribes, and examining why this tribe adopted such legislation is particularly relevant to North Dakota.

1. Vermont

On April 30, 2008, Vermont became the first state to pass legislation that created the new business entity, the L3C. The legislation was intentionally written to dovetail Treasury Regulations section 53.4944-3 and was strategically placed to qualify all L3Cs as for-profit ventures eligible for PRIs. Lang and a few others were the first to create an L3C, called L3C

120. See infra Part III.B (discussing Vermont, Illinois, and the Crow Indian Nation).
121. See infra Part III.B.1 (examining Vermont’s L3C legislation and the various L3Cs that have been formed in the state, including CoolPass, L3C).
122. Kelley, supra note 4, at 376 (citing H. 775, 2008 Gen. Assemb. (Vt. 2008)).
123. See infra Part III.B.2 (explaining how Illinois has proposed to use the L3C structure in the struggling newspaper industry).
124. See id.
127. Witkin, supra note 55.
128. The Concept of the L3C, AMERICANS FOR COMMUNITY DEVELOPMENT, http://www.americansforcommunitydevelopment.org/concept.php (last visited Feb. 24, 2011) [hereinafter The Concept of the L3C]. Title 11 of the Vermont Statutes Annotated section 3001, subsection 27 was added and reads:

“L3C” or “low-profit limited liability company” means a person organized under this chapter that is organized for a business purpose that satisfies and is at all times operated to satisfy each of the following requirements:

(A) The company:
(i) significantly furthers the accomplishment of one or more charitable or educational purposes within the meaning of Section 170(c)(2)(B) of the Internal Revenue Code of 1986, 26 U.S.C. § 170(c)(2)(B); and
(ii) would not have been formed but for the company’s relationship to the accomplishment of charitable or educational purposes.
Advisors, L3C.  

Today, more than one hundred L3Cs have been formed in the State of Vermont. A variety of L3Cs have been created, including “a chess camp, theater, alternative energy companies, publishers, food companies and numerous consulting firms.” The Vermont Legislature is hoping to inform foundations and donor-directed funds that L3Cs formed under the statute propose to work to carry out their business in a way that would qualify as PRIs.

Another Vermont L3C that was created soon after legislation was passed is CoolPass, L3C. CoolPass was organized on July 2, 2008. As discussed above, L3Cs must have a social mission. CoolPass’s social mission is to reduce the carbon footprint as a carbon offsetter program. As a carbon offsetter, CoolPass purchases credits from other businesses scaling down their greenhouse gas emissions or engaging in renewable energy projects. The business turns around and markets those credits to individuals and businesses hoping to offset their carbon dioxide emissions. CoolPass then permanently withdraws the credits from the available pool. The credit producers receive revenue from turning credits into

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

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

(D) If a company that met the definition . . . at its formation at any time ceases to satisfy any one of the requirements, it shall immediately cease to be a low-profit limited liability company, but by continuing to meet all the other requirements of this chapter, will continue to exist as a limited liability company. The name of the company must be changed to be in conformance . . . of this title.


130. Witkin, supra note 55.


132. Id.


135. Low-Profit Limited Liability Company, supra note 133.

136. See supra Part III.A (explaining the L3C is formed to carry out one or more social missions).

137. Mission, supra note 134.

138. Id.

139. Id.

140. Id.
The business, therefore, can create an incentive for emission reduction and renewable energy projects because they are no longer unprofitable. CoolPass attempts to use the L3C structure “to bring together a mix of foundations, trusts, endowments, investors, corporations, and government in order to achieve [its] social objectives while operating according to for-profit metrics.”

CoolPass also helps low-income homeowners obtain “EnergyStar efficient furnaces, hot water heaters, insulation and other home upgrades.” CoolPass reduces the amount of aggregate energy used by low-income homeowners, which, in turn, reduces the amount of carbon dioxide in the atmosphere, offsets greenhouse gases, and lowers energy costs of homeowners. CoolPass’s “funding and distribution model provides the sustainable[,] cooperative financial framework necessary to create the velocity to go beyond offsetting and retiring [g]reenhouse [g]as [e]missions.”

2. Illinois

On August 4, 2009, Illinois Governor Pat Quinn signed a bill that amended Illinois’s Limited Liability Company Act to allow for the L3C’s creation. The Illinois Legislature hopes the law, which took effect on January 1, 2010, will spark an inflow of capital to social enterprises. Illinois’ foundations have approximately $350 billion in assets. Because foundations are required to invest five percent of their assets to keep their tax-exempt status, $17 billion dollars is potentially available should foundations choose to make PRIs in the L3Cs. Although there are a variety of L3C possibilities that could use this capital, there is one particular industry that hopes to use the L3C structure to take advantage of the foundations’ investment capital.
Illinois is home to two notable newspapers that are suffering under the economic times: The Peoria Journal Star and the Chicago Tribune. The newspaper industry’s hard times are evidenced by the growing number of newspaper publishers filing for Chapter 11 bankruptcy, such as the Tribune Co., which publishes the Chicago Tribune, the Sun Times Media Group, and the Journal Register Co. Lang suggests the L3C structure could potentially benefit this hurting industry. Specifically, Lang points out that under the L3C structure, the current profit would be sufficient because the newspaper would merely be a low-profit entity. Although the newspaper industry may not be a high-profit venture, there is a social benefit in creating jobs and educating the public, and it is important to provide a structure for these businesses to flourish.

3. Crow Indian Nation

The Crow Indian Nation consists of approximately 11,000 members. The Crow Indian Reservation is located at the southern edge of the State of Montana. Operating under its own tribal government and its own laws, the Crow Indian Nation is a sovereign nation separate from that of the state.

152. See id.
154. See Duros, supra note 72. The L3C is merely a hypothetical solution for the newspaper industry at this time. L3Cs are only open to those businesses “organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition . . . or for the prevention of cruelty to children or animals.” 26 U.S.C. § 170(c)(2)(B) (2006). Thus, there is still a question as to whether a newspaper fulfills a charitable or an educational purpose. Federal legislation attempts to cure the uncertainty by expanding the permissible social missions to include newspapers. Leonard Jacobs, New Models: The Low-Profit Limited Liability Company, THE CLYDE FITCH REP., Mar. 13, 2009, http://www.clydefitchreport.com/?p=1257; see Duros, supra note 90. However, without passing this legislation, the Program-Related Investment Promotion Act, forming a newspaper L3C would be unlikely. Duros, supra note 72 (quoting Jennifer Towery, Peoria Newspaper Guild President). But see Chicago’s L3C Newsroom, THE NONPROFIT ROAD (Oct. 23, 2009), http://journalismnonprofit.blogspot.com/2009/10/chicagos-l3c-newsroom.html (stating Chicago News Cooperative will begin as an L3C after January 1, 2010).
155. See Duros, supra note 90.
156. Id.
157. Id.
159. Id.
160. Id.
Before the Tribe attempted to adopt the L3C legislation, the Crow Indian Nation had desired to engage in commerce with the surrounding fifty states. Accordingly, the Tribe adopted laws, such as foreclosure laws, providing commercial lenders with a remedy in the event of a default. The Tribe also adopted the Uniform Commercial Code for general commercial transactions. Finally, on January 13, 2009, the Crow Indian Nation adopted legislation creating the L3C.

The Crow Indian Nation viewed the L3C as a chance to develop economically. It was an opportunity to bring in foundation capital, which would successively attract private sector money. After obtaining the capital, ideally the business would then become successful at some point in the future, and the foundation could redeem its shares. By redeeming its shares, the foundation would get its capital back and could freely invest that money as it chose. Meanwhile, the Tribe would own the business outright. Thus, the Tribe could use the L3C structure to build tribal businesses with the help of a foundation’s investment and leverage private sector capital. The Crow Indian Nation demonstrates how the L3C could effectively be used to boost a local economy, using the strengths of the L3C structure.

IV. ENCOURAGING A SOCIAL MISSION IN NORTH DAKOTA

North Dakota legislators have already been presented with a bill that sought to introduce the L3C, but failed to pass the legislation. This section explores the necessary revisions to the North Dakota Century Code that would bring the L3C to life in North Dakota. In addition to examining how the North Dakota Legislature could effectively adopt language to create the L3C, this section discusses the most significant shortcoming

---

161. Lane Part 4, supra note 107.
162. Id.
163. Id.
164. AMERICANS FOR COMMUNITY DEVELOPMENT, supra note 115.
165. Lane Part 4, supra note 107.
166. Id.
167. Id.
168. Id.
169. Id.
171. See infra Part IV.A (elaborating on the language of the L3C legislation originally proposed to the North Dakota Legislature).
surrounding the L3C structure. The section focuses particularly on why North Dakota legislators should keep an open mind when faced with a new bill attempting to create the L3C.

A. OPENING THE DOORS TO A NEW LIMITED LIABILITY COMPANY

On January 19, 2009, North Dakota House Bill 1545 was introduced during the 2009 legislative session. The bill was introduced to amend the North Dakota Limited Liability Company Act. Because an L3C is not a nonprofit entity, but a for-profit entity with a nonprofit soul, the statute the bill sought to amend was the North Dakota Limited Liability Company Act, as opposed to the North Dakota Nonprofit Limited Liability Company Act. In fact, the L3C is merely a special kind of LLC. Thus, following Vermont’s lead, North Dakota targeted the LLC Act.

To introduce the L3C, North Dakota need only amend a few paragraphs of the existing Limited Liability Company Act. First, the definition of the L3C must be incorporated into the Limited Liability Company Act. The definition establishes that an L3C has a business purpose. The business purpose language is important because it furthers the notion that an L3C is a for-profit entity; thus, the business does not achieve tax-exempt status after filing the L3C articles of organization. The definition also includes the L3C requirements. The L3C requirements are unique because they mirror 26 U.S.C. § 4944(c), which aids the presumption of the L3C’s PRI eligibility. The L3C requirement language is extremely

---

172. See infra Part IV.B (discussing how the optimism surrounding the L3C’s benefits to the foundations, businesses with a social mission, the public, and the North Dakota economy should not be forgotten in the face of the L3C’s uncertainty).

173. Id.


175. Id. However, the bill was amended to a mere study of the L3C’s feasibility and desirability. H.R. 1545 (as passed by House, Feb. 3, 2009).


179. See id. § 3001(27); see also H.R. 1545 (as introduced, Jan. 19, 2009).

180. See H.R. 1545 (as introduced, Jan. 19, 2009).

181. Id.

182. Searing, supra note 66.

183. See H.R. 1545 (as introduced, Jan. 19, 2009).

184. Compare H.R. 1545 (as introduced, Jan. 19, 2009), with 26 U.S.C. § 4944(c) (2006), and 26 U.S.C § 170(c)(2)(B) (providing that investments where the primary purpose of which is to be “organized and operated exclusively for religious, charitable, scientific, literary, or educational
important because it preserves the L3C’s most unique attraction: its status as a qualified recipient for PRIs. The L3C, however, must at all times satisfy the specified requirements to retain its qualifying status.

Next, the Limited Liability Company Act would also be amended to require all L3C businesses to include “low-profit limited liability company,” “L3C,” or “l3c” in the name of the business. Requiring businesses to include the L3C designation serves a dual purpose. First, it puts foundations willing to make PRIs to for-profit ventures on notice that the business is eligible for those investments. Second, attaching “L3C” to the business name “signal[s] to . . . customers, employees, vendors, and [the] communit[y]” that the business achieves a charitable or educational purpose.

House Bill 1545, as it was originally proposed, did not include the necessary language from 26 U.S.C. § 4944(c) and 26 U.S.C. § 170(c)(2)(B).

The language discussed above could all be found in the original version of North Dakota House Bill 1545. The bill, nevertheless, ignored the consequence of an L3C failing to satisfy the specified requirements. The Vermont L3C statute provides guidance on this defect. Vermont’s version of the statute states that if the business that files to be an L3C “at any time ceases to satisfy any one of the requirements, it shall immediately cease to be a low-profit limited liability company, but by continuing to meet all the other requirements of this chapter, will continue to exist as a limited liability company.” Thus, a L3C is merely a LLC with a special status, but the L3C can lose its special status by failing to meet the statutory requirements.

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, and where income production or appreciation of property is not a material purpose).

185. Lang, supra note 55, at 254, 256.
186. H.R. 1545 (as introduced, Jan. 19, 2009).
187. Id. (amending N.D. CENT. CODE § 10-32-10(1)(b)).
188. Steve Davis & Sue Woodrow, The L3C: A New Business Model For Socially Responsible Investing, COMMUNITY DIVIDEND (Nov. 2009), http://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=4305.
191. See H.R. 1545 (as introduced, Jan. 19, 2009).
192. See id.
194. Id. § 3001(27)(D).
195. Id.
Together, these amendments to the Limited Liability Company Act will serve to bridge the gap between the for-profit and nonprofit sectors in North Dakota. The next section will examine how the L3C could specifically benefit the State of North Dakota. Conversely, the section also addresses the most significant shortcoming attached to the L3C structure.

B. L3C IN NORTH DAKOTA

House Bill 1545 as it was enacted seeks to study “the feasibility and desirability of creating . . . [the] low-profit limited liability company.” This section first observes data regarding foundations and the State of North Dakota. The section continues by focusing on the potential benefits and uses the L3C would have in North Dakota, but also addresses the greatest problem that accompanies the L3C structure.

In 2007, North Dakota was home to less than one hundred foundations. Those foundations made distributions totaling approximately $310 million. The total amount of qualifying distributions that were made by these foundations in 2007 totaled an estimated $19,348,000. Qualifying distributions are those expenditures used in calculating the foundation’s required payout that includes “total giving, as well as reasonable administrative expenses, set-asides, PRIs, operating program expenses, and [the] amount to acquire assets used directly for charitable purposes.” The roughly nineteen million dollars paid out by North Dakota foundations was the lowest total in the United States.

It could be argued L3C legislation should not be passed because North Dakota’s foundation assets do not produce a significant qualified distributions requirement. However, the L3C can also be viewed as a way to increase North Dakota foundations’ distributions and a way to make their qualifying distributions go further. For example, in 2007, roughly eight

196. See infra Part IV.B (pointing out the benefits to North Dakota foundations, businesses with a social mission, and the public).
197. See infra Part IV.B (addressing the uncertainty attached to the L3C created by the IRS’s silence).
199. See infra Part IV.B (providing the number of foundations in North Dakota, their total asset values, and their qualifying distribution numbers).
200. See infra Part IV.B (explaining the increased capital reaching ventures that provide a social benefit, but also discussing how the IRS’s silence on the L3C has created uncertainty with the L3C movement).
202. Id.
203. Id.
204. Id.
205. Id.
million dollars were given out in the form of grants by North Dakota foundations.\footnote{Geographic Distribution of Grants Awarded and Grants Received by State, circa 2007, FOUNDATION CENTER (2009), http://foundationcenter.org/findfunders/statistics/pdf/03_fund geo/2007/08_07.pdf.} Unfortunately, once grant money is spent, it cannot be reused by the foundation.\footnote{Searing, supra note 66.} North Dakota could expand the use of this money by utilizing the L3C.

If a foundation were to use part of the eight million dollars in grants to purchase equity in fledgling businesses that still have a charitable purpose, the money would still be used to achieve a social benefit. The foundation could also receive a potential one percent return, and, if or when the business becomes self-sufficient, the foundation could redeem its interest or sell its interest.\footnote{See Kelley, supra note 4, at 374; Lane Part 4, supra note 107.} Thus, the foundation would have the one percent return and the value of the equity to reinvest in another L3C or give away in a grant. The money achieves a social purpose in both scenarios, but in the latter, the money can be recycled to achieve more social good. The L3C, therefore, could serve as a useful tool to increase the amount of money reaching North Dakota citizens.

In 2007, North Dakota grant recipients were awarded grants from not only North Dakota foundations, but also from out-of-state foundations.\footnote{Top 50 Recipients of Foundation Grants in the State of North Dakota, circa 2007, FOUNDATION CENTER (2009), http://foundationcenter.org/findfunders/statistics/pdf/03_fund_geo/2007/50_recp_states/r_nd_07.pdf.} Of the top fifty United States foundations awarding grants in the State of North Dakota, North Dakota received 304 grants that totaled $18,760,704.\footnote{Fiscal Data of Grantmaking by Region and State, 2007, supra note 201.} Over $11 million of the $18,760,704 came from the neighboring State of Minnesota.\footnote{Top 50 Recipients of Foundation Grants in the State of North Dakota, circa 2007, supra note 209.} In 2007, Minnesota’s foundations had assets totaling almost $14 billion and made qualifying distributions of nearly $1 billion.\footnote{Fiscal Data of Grantmaking by Region and State, 2007, supra note 201.} Because North Dakota L3Cs have the ability to receive PRIs from foundations outside the state, North Dakota businesses could potentially tap into a large reservoir of capital that could be used for charitable purposes.\footnote{Id.}

If the L3Cs are able to attract outside PRIs, because of the trianching structure, those in the private sector will be more inclined to invest their private capital investments.\footnote{Kelley, supra note 4, at 374; Lane Part 4, supra note 107; The L3C: Low-Profit Limited Liability Company, supra note 92.} The private capital investments, such as pen-
sions or endowment investments, open the flood gates to money not presently accessible for socially beneficial investment. Opening the doors to PRIs and private capital investments means L3Cs could be used in a number of ways: “alternative energy, food bank processing, social services, social benefit consulting and media, arts funding, job creation programs, economic development, housing for low income and aging populations, medical facilities, environmental remediation, and medical research.”

L3Cs could bring social benefits and additional resources into the State of North Dakota that could do a small part in creating jobs and sparking a boost in the local economy. The potential for benefit surrounding the L3C is evident, but it is also important to look at its shortcomings.

The greatest issue surrounding the L3C is uncertainty. The IRS has not yet decided “whether a private foundation’s investment in L3C could qualify as a program-related investment (PRI) under section 4944(c).” Private foundations will persist in their reluctance to make PRIs in L3Cs without receiving regulatory direction from the IRS. The IRS, thus, creates a large barrier because the essential purpose of starting an L3C, which is to gain access to PRIs, is made futile until the IRS blesses the L3C as a PRI vehicle. However, with the growing number of states adopting the legislation and 232 L3Cs organized nationwide, there is great optimism that the L3C will soon be embraced with open arms, creating a much needed fourth sector.

V. CONCLUSION

Returning to the words of Bill Gates, we must “stretch the reach of market forces so that more people can make a profit, or at least make a living, serving people who are suffering from the worst inequities.” Vermont’s adoption of L3C legislation is a step in the right direction toward achieving that goal. The North Dakota Legislature should follow the

215. The Concept of the L3C, supra note 129; The L3C: Low-Profit Limited Liability Company, supra note 92.
216. Witkin, supra note 55.
218. Id.
219. Bately, supra note 189.
220. See Witkin, supra note 55; INTERSECTOR PARTNERS, L3C, supra note 119.
221. Gates, supra note 1.
222. See generally Lang, supra note 55, at 253 (stating “[a]n L3C is formed in order to perform one or more social missions at the lowest possible cost with the most efficiency and with as much potential revenue as possible going to further the social mission”).
lead of other states, such as Vermont, Michigan, and Illinois, and keep an open mind to the new L3C legislation. By adopting the L3C legislation, North Dakota can begin combining financial and social bottom lines, allowing success to benefit more than just the interest holders.

Mark R. Krogstad*

---

223. See supra Part IV.A-B (discussing potential benefits the L3C would make available to North Dakota).

224. See Lang, supra note 55, at 253.

*2010 J.D. with distinction from the University of North Dakota School of Law. I would like to take this opportunity to thank both my family, for all of their support over the years, and my loving wife, Tiffany, who serves as my North Star, a constant that brings me home every day and a continual reminder of how fortunate I am.