Program-Related Investing in L3Cs: A Question-and-Answer Guide

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Are special-purpose LLCs the best—or even an appropriate—entity for a private foundation seeking to make program-related investments? The low-profit LLC pioneered in Vermont and adopted in less than a dozen jurisdictions has PRI requirements "hardwired" into its governing documents, but whether this will make it easier for a foundation's PRIs to qualify remains an open question.

Over the past few years there has been much debate, sometimes acrimonious, over the "low-profit limited liability company" (L3C), a form specifically developed to facilitate program-related investments (PRIs) by private foundations. Advocates of the form have hailed it as the "for-profit with the nonprofit soul,"[1] an entity designed to operate "in the space between the nonprofit and the pure for profit organization to perform a social mission."[2] Opponents have denounced it as "unnecessary and unwise"[3] and a "useless gadget[],"[4] and have called the statutes that created L3Cs "nonsensical."[5] At the same time, however, it's a fair bet that few private foundations considering PRIs have actually encountered an L3C in practice.

What exactly is an L3C, and why has there been such controversy over it? Do they actually facilitate PRIs, and if so, how? Are there pitfalls to making PRIs in L3Cs?

These questions and others will be examined below, in a practical format that will avoid taking sides in the debate while pointing out some very real dangers inherent in the L3C form that, in the worst of cases, could be exploited by less-than-scrupulous promoters at the expense of foundations unfamiliar with the L3C or inexperienced at making PRIs.

PRIs GENERALLY

As noted above, L3Cs were designed to facilitate PRI-making by private foundations, and we'll look at whether they in fact do so. First, a more basic question: What is a PRI?

PRIs are a special safe harbor from the prohibition on "jeopardizing in-

EXHIBIT 1

PRI Regulations Compared With Vermont Criteria for L3C Qualification

Regs. 53.4944-3(a)(1) and (2)	Vermont L3C statute (Vt. Stat. Tit. 11, section 3001(27))
A program-related investment is an investment which possesses the following characteristics:	"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:
1. The primary purpose of the investment is to accomplish one or more of the purposes described in Section 170(c)(2)(B);	(A) The company:
An investment shall be considered as made primarily to accomplish one or more of the purposes described in Section 170(c)(2)(B) if:	
(i) it significantly furthers the accomplishment of the private foundation's exempt activities and	(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...;
(ii) if the investment would not have been made but for such relationship between the investment and the accomplishment of the foundation's exempt activities.	(ii) would not have been formed but for the company's relationship to the accomplishment of charitable or educational purposes.
2. No significant purpose of the investment is the production of income or the appreciation of property; and	(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.
3. No purpose of the investment is to accomplish one or more of the purposes described in Section 170(c)(2)(D) [i.e., the investment must not fund electioneering, and it may fund lobbying only to a very limited extent].	(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. sec. 170(c)(2)(D).

vestments" under Section 4944, which imposes a prudent-investment standard on foundations and their boards. When a private foundation makes an investment in any manner that would jeopardize its ability to carry out its exempt purposes—for example, a highly risky and imprudent investment in derivatives that could ruin the organization or cause it to significantly curtail its grants or programs—Section 4944 levies stiff penalty taxes on the foundation and sometimes on its managers.[6]

A PRI is an investment that may be imprudent under normal standards but nonetheless is excluded from being a jeopardizing investment under Section 4944 because it meets certain specific tests for advancing the foundation's charitable mission and does not have capital gain or the production of income as a significant purpose. As such, a PRI is more like a charitable grant than a normal investment. PRIs can offer several advantages over traditional grantmaking, however.

Unlike grants, PRIs offer foundations the prospect of using the same funds to further charitable purposes again and again, so long as at least the principal is recouped after each investment. Also, PRIs offer more flexibility than grants: a foundation can make a $1 million equity investment in a for-profit business located in a severely depressed neighborhood, with the aim of sparking community redevelopment,[7] whereas the terms under which it could make a grant to the same recipient would be more limited.[8]

The Section 4944 Regulations set out specific criteria (quoted in the left-hand column of Exhibit 1) that an investment must meet in order to qualify as a PRI, and the L3C form was developed around these criteria.[9]

WHAT IS AN L3C?

The L3C is an ordinary limited liability company whose organizational documents contain language, prescribed by statute,[10] that is similar to the conditions an investment must meet under the Section 4944 Regulations to qualify as a PRI. The theory behind the L3C approach is that by hard-wiring the PRI restrictions into the very structure of the LLC, it should be much easier for an investment in an L3C to qualify as a PRI.

To be an L3C, a company must meet and generally must include in its organizational documents[11] the following conditions:

- The L3C must significantly further the accomplishment of one or more charitable or educational purposes, as defined in Section 170(c)(2)(B).

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- The company must not have been formed but for its relationship to these purposes.
- Investment return—the production of income or the appreciation of property—cannot be a significant purpose behind the company, although the fact that it actually does generate investment return is not conclusive evidence of such a purpose.
- The company must not pursue political or legislative activities within the meaning of Section 170(c)(2)(D).

The right-hand column of Exhibit 1 quotes the L3C criteria from Vermont, the first state to adopt an L3C statute.

Otherwise, an L3C is functionally the same as any other LLC: it offers the same degree of limited liability under state law, and federal tax law treats it like an ordinary LLC. In fact, even in states where L3C statutes have not yet been enacted, it should generally be possible to add L3C-like provisions to the organizational documents of a standard LLC, creating an L3C in all but name.[12]

Does a Company Receive a Formal Determination That it Qualifies as an L3C?

No. To be an L3C, an otherwise regular LLC simply needs to meet the requirements described above. Likewise, it can lapse from L3C status simply by no longer meeting these requirements (for example, by amending its governing documents to remove the prescribed language). No state regulatory agency confirms that companies calling themselves L3Cs meet the statutory criteria for doing so.

Is the L3C Similar to Other New Hybrid Social-Enterprise Forms?

The L3C is often grouped with hybrid corporations—the benefit corporation and, in California, the flexible purpose corporation—in discussions of social-enterprise vehicles. There are important differences, however.

First, there's the basic matter that the L3C was designed specifically to facilitate PRIs, whereas hybrid corporations were intended for much more diverse uses. Although L3Cs are not limited to arrangements involving PRIs—for example, a charity could operate an after-school program for disadvantaged youth through an L3C, helping to shield itself from liability while taking advantage of the L3C brand to signal the company's charitable purpose—the restriction on an L3C's pursuit of investment return as a significant purpose narrows its potential utility in other contexts.

By contrast, a benefit corporation's purpose must be to create a general public benefit, and its directors must take constituencies other than shareholders into consideration, but it is not otherwise restricted from pursuing financial return as a significant goal. Accordingly, the benefit corporation can be used in a wide array of enterprises, from strictly social missions where investment return is not a significant purpose at all, to situations where shareholders really are looking to make a profit in addition to creating a general public benefit. Other considerations aside, an L3C would work in the former case, but probably not the latter.

Second, there is a difference in tax treatment. As an otherwise standard LLC for federal tax purposes, the L3C is by default either disregarded altogether (if it has a sole member) or is treated as a partnership (if there are two or more members).[13] By contrast, a benefit or flexible purpose corporation is taxed like an ordinary corporation.

The advantage here is that there's no entity-level taxation with an L3C. The potential downside is that an L3C's activities and the nature of its income are attributed to the L3C's members themselves for federal tax purposes, which is not true for shareholders in a hybrid corporation.[14] If an investment in an L3C turns out not to qualify as a PRI (and how it might not will be discussed below), the investing foundation might (among other possible adverse consequences) incur unrelated business income tax on allocations from the L3C. This is less likely to happen with dividends received from a hybrid corporation.

Third, shareholders in hybrid corporations enjoy certain statutory pro-

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1 Lang, "The L3C & Economic Development" (available at www.americansforcommunitydevelopment.org/downloads/the L3C & Economic Development.pdf).

2 *Id.*

3 Kleinberger, "A Myth Deconstructed: The 'Emperor's New Clothes' on the Low-Profit Limited Liability Company," 35 Del. J. Corp. L. 879 (2010), page 881. See also Chernoff, "L3Cs: Less Than Meets the Eye," 21 Tax'n of Exempts No. 6 (May/June 2010), page 3. In addition, the Committee on Limited Liability Companies, Partnerships and Unincorporated Entities of the ABA's Section of Business Law issued a resolution on 4/23/10 urging state legislatures not to adopt L3C legislation.

4 Callison, "L3Cs: Useless Gadgets?," 19 Bus. L. Today No. 2 (November/December 2009), available at apps.americanbar.org/buslaw/blt/2009-11-12/nonbindingopinions.shtml.

5 Kleinberger, *supra* note 2.

6 For further information, see www.irs.gov/charities/foundations/article/0,,id=160678,00.html/.

7 See Reg. 53.4944-3(b), Example 3.

8 A private foundation can make a PRI to *significantly further* a Section 170(c)(2)(B) purpose, even though the underlying business activity is not itself charitable, while a grant for any purpose "other than one specified in Section 170(c)(2)(B)" will be a taxable expenditure under Section 4945.

9 The Section 4944 Regulations also provide several illustrations of program-related investing that private foundations were doing at the time the Regulations were adopted in 1972. A notice of proposed rulemaking (REG-144267-11, 4/19/12) would add new, more up-to-date examples of program-related investing. See generally Levitt and Wexler, "Proposed Regulations Would Bring Program-Related Investments Into the 21st century," 117 JTAX 100 (August 2012). None of these examples address PRIs in L3Cs specifically, however, or even more generally equity investments in LLCs, although one illustration—Example 16—does consider a situation where a foundation proposes to make a PRI loan to an LLC.

10 To date, L3C legislation has been enacted in nine states and two federal tribal jurisdictions: Illinois, Louisiana, Maine, Michigan, North Carolina, Rhode Island (effective July 2012), Utah, Vermont, and Wyoming, as well as the Oglala Sioux Tribe and the Crow Indian Nation of Montana.

11 The statutes differ slightly in what exactly an L3C's organizational documents need to recite. For example, Michigan requires all conditions to be stated in an L3C's articles; Illinois requires only two to be stated in the articles, while Wyoming and Louisiana require the articles to state a business purpose that satisfies all prongs.

12 See, e.g., note 10, *supra*. Although, for example, Delaware—a state usually preferred because of the flexibility of its corporate laws and its well-developed corporate jurisprudence—has not adopted L3C legislation, a Delaware LLC can be organized with specially tailored restrictions that duplicate those required for L3C status in the nine states that have adopted the special statutes.

13 An LLC can, of course, elect to be taxed as a corporation. See Reg. 301.7701-3.

14 See Rev. Rul. 98-15, 1998-1 CB 718.

tections that in the L3C context are left to private agreement. For example, hybrid corporations are required by law to report to shareholders and others on the performance of their social objectives.[15] Also, hybrid-corporation statutes generally require a supermajority vote by shareholders before a corporation can modify its social objectives or terminate its hybrid status.

By contrast, no L3C law requires an L3C to make similar reports to its members, and there are no supermajority-approval safeguards in L3C laws to prevent an L3C from changing its business purposes and converting back into a standard LLC. Any such requirements or restrictions need to be specially addressed in an L3C's governing documents or in separate contracts with investors.

Does Investment in an L3C Automatically Qualify as a PRI?

No. There is currently no mechanism under which an investment can automatically qualify as a PRI for all private foundations. For Internal Revenue Code purposes, moreover, there is nothing magical about having the special L3C language placed in a company's governing documents.

No regulatory agency at either the federal or state level certifies L3Cs as automatically validating PRIs. Indeed, on at least one occasion an IRS official has cautioned that "no one has really signed off" at the federal level on using L3Cs for making PRIs.[16]

Does an L3C Avoid the Need for a Private Ruling Before a Foundation Makes a PRI?

No, for the simple reason that a private foundation is not required to obtain a private ruling from the IRS before making a PRI. Even if a foundation were considering an L3C investment that posed novel issues under the PRI rules and sought a letter ruling to ensure that the investment qualified as a PRI, the mere fact that an L3C was being used would be unlikely in itself to reduce any of the concern that prompted the decision to obtain a letter ruling in the first place.

Do the Restrictions Hardwired Into an L3C's Governing Documents Make the PRI Analysis Easier?

The PRI analysis may become *somewhat* easier when an L3C is involved, but a foundation still needs to go through the same investigatory steps that it would do before investing in something other than an L3C.

The following questions are some of the more important ones that a foundation's managers need to ask when examining whether an investment in an L3C would qualify as a PRI:

1. Does the L3C actually significantly further charitable or educational purposes? Simply because an L3C's governing documents restrict it to significantly furthering a Section 170(c)(2)(B) purpose does not mean, of course, that the L3C actually furthers such a purpose.

In analyzing whether an investment qualifies as a PRI, a private foundation's managers or legal counsel need to examine the L3C's business plans and private placement memoranda (if any), and talk to the L3C's managers to assess what activities the L3C actually will be carrying out. Only at that point can the foundation determine whether these activities actually do significantly further a Section 170(c)(2)(B) purpose.

2. Does the L3C significantly further an actual exempt purpose of the investing foundation? As explained above, the criteria for qualifying as an L3C were taken from the Section 4944 Regulations but, as shown in the side-by-side comparison in Exhibit 1, they are *not* identical to the PRI criteria. In fact, the L3C criteria involve a fundamental shift of perspective: Whereas the Section 4944 Regulations speak about a particular *investment* and the particular *private foundation investor*, the L3C criteria shift the focus to the *investee* itself, without regard to the specific private foundation making the investment.

This is a subtle but critical change. It isn't enough under the Section 4944 Regulations for an investment to significantly further *any* charitable or educational purpose under Section 170(c)(2)(B)—rather, it must significantly further *a charitable or educational purpose of the foundation that wants the investment to be a PRI*. In other words, if a foundation looking to make a PRI in a microfinance fund to alleviate poverty in West Africa has focused exclusively on making grants to support the arts in Seattle and has never contemplated broader activity, the proposed investment is unlikely to qualify as a PRI for the foundation, even if it furthers a charitable purpose under Section 170(c)(2)(B) and would be a valid PRI for another foundation. This part of the PRI analysis is highly specific to each investing foundation.

3. Would the L3C not have been formed but for its relationship to the accomplishment of charitable or educational purposes? In this but-for test, the dissonance between the language of the PRI Regulations and the language in L3C statutes becomes especially acute. As a condition for self-qualifying as an L3C, the company itself needs to be organized and operated in a way that demonstrates it would not have been formed but for its relationship to the accomplishment of charitable or educational purposes.

The PRI Regulations ask a completely different question, however: Would the *foundation* refrain from making the investment but for the investment's relation to the accomplish-

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15 An L3C, along with standard LLCs, may be required by state law to submit annual "report" forms and returns to local regulators and taxing authorities, but this is different from the far more substantive reporting required for hybrid corporations.

16 See www.thenonprofittimes.com/article/detail/the-l3c-status-2418 (quoting the comments of Ron Schultz, senior technical advisor with the Service's Tax Exempt and Government Entities Division, during an AICPA conference in 2009).

17 See, e.g., www.americansforcommunitydevelopment.org/downloads/CommunityFoundationsAndL3C.pdf (describing the possibility of having various investor tranches in an L3C).

18 See generally the discussion in Callison and Vestal, "The L3C Illusion: Why Low-Profit Limited Liability Companies Will Not Stimulate Socially Optimal Private Foundation Investment In Entrepreneurial Ventures," 35 Vermont L. Rev. 273 (2010), page 285, where the authors point out that the aspirations for using L3Cs for tranched investments runs directly counter to the restriction in L3C statutes on having the production of income or the appreciation of property as a significant purpose for the company.

19 Kleinberger, "ABA Business Law Section, on behalf of its committees on LLCs and Nonprofit Organizations, opposes legislation for low profit limited liability companies (L3Cs)," William Mitchell College of Law, Legal Studies Research Paper 2012-05 (2012).

20 *Id.*

ment of the *foundation's* exempt purposes? A foundation could make an equity investment primarily for business reasons in an L3C that it felt had unusual and underappreciated prospects for financial success; the L3C's mission might have considerable influence on the investment decision, but it would not necessarily be the but-for factor. In this instance, the investment might not qualify as a PRI, and the fact that the L3C itself would not have been formed but for its relation to the accomplishment of a charitable or educational purpose would have little bearing on the analysis.

4. Is the production of income or the appreciation of property in fact a significant purpose of the company? As with the other tests, the L3C restriction here flips the emphasis of the PRI Regulations from the investment to the investee. But shouldn't it stand to reason that if the L3C itself is restricted from having the significant purpose of producing financial return, no one looking for financial return would invest in the company either?

There are a few problems with this reasoning. First, the L3C's purpose would not necessarily have any bearing on investments in the L3C structured as loans. For example, a foundation could make a market-rate loan to an L3C for the sole purpose of recognizing income in the form of interest payments from the L3C. The fact that the L3C itself was restricted from having the production of income for its investors as a significant purpose would be irrelevant: the foundation's loan could fail to qualify as a PRI.

Second, even a foundation making an equity investment in an L3C needs to examine the L3C's business plan and investor marketing materials to make sure they harmonize with the restriction in its governing documents. Simply put, language in an L3C's operating agreement stating that production of income and appreciation of property are not significant purposes of the company may be of little use when the L3C's investor brochures talk about the prospect of substantial investment returns.

There is particular reason for suspecting that in many instances this limitation in an L3C's governing documents could be disingenuous. An important promotional point for the L3C concept has been the notion that different classes or "tranches" of investors can be assigned different levels of risk and return, with PRI investors absorbing a disproportionate amount of risk with relatively little return, and market-rate investors enjoying greater returns with less exposure to risk—so-called "tranching."[17] If for-profit investors are being lured with a promise of substantial returns, it may not mean much to state in governing documents that the production of income or the appreciation of property is not a significant purpose of the company as a whole.[18]

Another concern needs to be mentioned in connection with the topic of tranching. In an L3C with nonprofit and for-profit tranches, the foundation's PRI might be used as a platform for generating substantial private benefit for the for-profit investors. Although a PRI made in a for-profit vehicle will always result in some incidental private benefit, the tranching feature of the L3C presents a special danger, since it may more easily lead to the point where the private benefit provided to for-profit co-investors becomes so significant that it swamps the charitable or educational purpose being furthered by the PRI.

A draft letter circulated by a working group of the ABA's Business Law Section specifically calls out tranching as a dangerous proposition for private foundation investors: "[The] tranched investment structure commingles assets from private foundations with capital investments from private profit seekers and inevitably uses charitable assets to confer 'private benefit' on the for-profit investors in the recipient organization. If, qualitatively and quantitatively, those benefits are not merely incidental to furthering exempt purposes, the risk to the investing private foundation is extreme—i.e., loss of its tax exempt status."[19]

While tranching is a powerful tool, it may present an opportunity for abuse. A private foundation looking to make a PRI in an L3C where tranching is contemplated will need to weigh carefully the possibility of substantial private benefit against the potential for significantly furthering a Section 170(c)(2)(B) purpose.[20]

Ultimately, the key to this prong of the PRI test, again, is that the private foundation looking to make a PRI itself must determine that no significant purpose of *its* particular investment is the production of income or the appreciation of property. The terms governing the foundation's own investment—its relative place on the waterfall of profit distributions, any preferential rights to net assets on dissolution, and so forth—all affect the risk-return analysis, which in turn affects whether the production of income or the appreciation of property is likely to be considered a significant purpose behind the investment. Accordingly, the fact that an L3C's governing documents state this restriction verbatim from the statute may be helpful but is not conclusive to the PRI analysis for any particular foundation investor.

PRACTICE NOTES

Private foundations are generally not required to conduct expenditure responsibility over PRIs in public charities or, for that matter, in an LLC wholly owned by a public charity. As a practical matter, however, an L3C is likely to have multiple members, including either other private foundations or nonexempt investors, or both. Under these circumstances, a foundation making a PRI in the L3C must observe the expenditure-responsibility rules.

Once These Hurdles Are Cleared, Can a Foundation Proceed With Making the PRI?

Not necessarily. Even if an investment in an L3C meets the requirements for being a valid PRI under the Section 4944 Regulations, the foundation still needs to consider the prohibition on taxable expenditures under Section 4945. More specifically, a private

foundation making an otherwise valid PRI under Section 4944 can run afoul of Section 4945 if it does not conduct expenditure responsibility over the PRI if required to do so.

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For PRIs, the expenditure responsibility Regulations under Section 4945 provide that the foundation and the investment recipient must have a written commitment, signed by an officer, director, or trustee of the recipient, that requires the investee:

1. To use all the funds received from the foundation only for the purposes of the investment and to repay any portion not used for such purposes;
2. At least once a year during the existence of the PRI, to submit full and complete financial reports to the foundation of the type ordinarily required by commercial investors under similar circumstances, along with a statement that the recipient has complied with the terms of the PRI;
3. To maintain books and records adequate to provide information ordinarily required by commercial investors under similar circumstances and to make these books and records available to the foundation at reasonable times; and
4. Not to use any of the funds (a) to carry on propaganda, or otherwise to attempt, to influence legislation (within the meaning of Section 4945(d)(1)), (b) to influence the outcome of any specific public election, or to carry on, directly or indirectly, any voter registration drive (within the meaning of Section 4945(d)(2)), or (c) to make a grant to any private-foundation recipient that does not comply with the requirements of Sections 4945(d)(3) or (d)(4).

The tranching feature of the L3C may lead to the point where the private benefit provided to for-profit co-investors becomes so significant that it swamps the charitable or educational purpose being furthered by the PRI.

The L3C statutes are silent about the Section 4945 requirements, and a company can qualify as an L3C without having any provisions in its governing documents that address the expenditure-responsibility needs of private-foundation investors.[22] Although inapplicable to other investors in the L3C, these requirements are *critical* to foundations making PRIs. Accordingly, PRI investors will need to insist that the terms of their investments, whether set forth in the L3C's own operating agreement, in a side letter between the foundation and the L3C's managers, or in some other document, comply with these restrictions.[23]

In addition to the expenditure responsibility requirements under Section 4945, there are other issues that private foundations should address in evaluating a prospective investment in an L3C, none of which are resolved by the mere fact that the entity qualifies as an L3C under state law. Two examples include governance issues and qualifying distributions.

Governance issues. A company's governing documents may contain the necessary provisions for it to qualify as an L3C under state law, but what protections are in place to ensure that the company must remain an L3C for the term of the foundation's investment? In other words, can the foundation's for-profit co-investors amend the company's governing documents to cause its L3C status to lapse and the company to pursue other purposes, and if so, what rights does the foundation have to recover its investment?

A well-negotiated operating agreement or side letter should protect a private-foundation investor by requiring the company to repay the foundation's investment if the funds are no longer to be used for PRI purposes. As discussed above, this is necessitated by the Section 4945 expenditure responsibility Regulations.

Can the foundation count a qualifying distribution under Section 4942? For example, a written commitment by a private foundation to guarantee the obligations of an L3C may constitute a valid PRI when entered into, but it generally cannot be counted as a qualifying distribution by the foundation until the commitment is actually called.

WHY USE AN L3C INSTEAD OF A REGULAR LLC FOR A PRI?

An L3C may have some advantages over a regular LLC:

1. While an L3C structure is by no means dispositive of the PRI analysis, certain aspects of the L3C—such as the fact that an L3C's governing documents are generally required to enunciate the charita-

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21 Under guidance from the IRS, a private foundation making payments to an entity that is disregarded as separate from its public charity parent is not required to conduct expenditure responsibility. See IRS Information Letter 2010-0052 (6/25/10).

22 Typically, the restrictions in L3C statutes adapted from the Section 4944 Regulations address only items (a) and (b) of the fourth requirement for expenditure responsibility under the Section 4945 Regulations because these are also requirements under Section 4944.

23 The authors are aware of at least one effort in progress to create a model L3C operating agreement that reflects the expenditure responsibility requirements described here.

24 See generally Lane, "The Illinois Low-Profit Limited Liability Company (L3C)," available at marcjlane.com/clientuploads/l3cbook.pdf.

ble or educational purpose that the company will be furthering—can facilitate that analysis.

2. Also, the PRI-centric nature of the L3C structure should serve to bring all investors onto the same page: by using the L3C, company managers effectively put everyone on notice that the entity has been set up to attract PRIs, and for-profit investors should not be surprised when the PRI-like restrictions appear in the L3C's governing documents or when PRI investors require special terms in the operating agreement or in side letters giving them the expenditure-responsibility provisions they need.
3. It could be argued that because the "LLC" moniker is so connected with the for-profit sector, the L3C brand, if eventually associated in the public mind with charitable endeavors, could bring special value in itself.

On the other hand, there is nothing functional about an L3C that could not be duplicated in a regular LLC. A normal LLC can be set up to serve social purposes, and by express provisions in the operating agreement, members can align the fiduciary duties of their managers with these social objectives. Also, when forming an L3C, investors have only nine jurisdictions at the moment to choose from. Investors from outside these jurisdictions may prefer to form the company in Delaware, with its flexible, well-vetted LLC law and a corporate jurisprudence that is respected by legal practitioners across the country. Delaware currently does not offer the L3C option. Finally, it is possible that an L3C could be subject to special regulatory oversight (e.g., L3Cs in Illinois are categorically required to register with the Attoney General[24]).

CONCLUSION

In large measure, the challenges of making a PRI in an L3C are similar to, if not the same as, the challenges of making a PRI in a standard LLC or similar vehicle. The discussion in this article is meant to highlight this basic fact and to illustrate the need for foundation managers, when faced with the chance to make a PRI in an L3C, to conduct the appropriate due diligence, as they would for any other PRI, and not to rely too heavily on the L3C's special packaging.