

# IN SEARCH OF A UNIQUE IDENTITY: THE L3C AS A SOCIALLY RECOGNIZED BRAND

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## I. INTRODUCTION

The driving force for the decision to organize a new business venture as a limited liability company (“LLC”) is typically the desire to achieve favorable pass-through income tax treatment, while simultaneously enjoying the protection of limited liability for its owners.<sup>1</sup> As noted by one court, “[t]he allure of the limited liability company is its unique ability to bring together in a single business organization the best features of all other business forms—properly structured, its owners obtain both a corporate-style liability shield and the pass-through tax benefits of a partnership.”<sup>2</sup>

During the twenty-year period between 1977 and 1997, the legal and business communities in the United States experienced the passage of fifty state statutes creating LLCs.<sup>3</sup> In 1977, Wyoming passed the first LLC statute,<sup>4</sup> and the last state to make this statutory adoption was Hawaii in 1997.<sup>5</sup> The climate of state statutory changes did not end with the proliferation of LLC provisions, as will be further discussed.

Now that all fifty states have adopted statutes creating LLCs, this form of business ownership should be attractive as the business structure of choice for new and existing businesses wishing to limit their personal liability and to be taxed as a partnership.<sup>6</sup> As entrepreneurs make early start-up decisions regarding entity formation, they may soon realize that there are many possible forms from which they may choose.<sup>7</sup> In addition to the

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<sup>1</sup> See Tanya M. Marcum & Eden S. Blair, *Entrepreneurial Decisions and the Legal Issues in Early Venture Stages: Advice that Shouldn't Be Ignored*, 54 BUS. HOR. 143, 146 (2011).

<sup>2</sup> PB Real Estate, Inc. v. DEM II Properties, 719 A.2d 73, 74 (Conn. App. Ct. 1998).

<sup>3</sup> Susan Pace Hamill, *The Origins Behind the Limited Liability Company*, 59 OHIO ST. L.J. 1459, 1460 (1998).

<sup>4</sup> WYO. STAT. ANN. §§17-15-101 to 17-143 (1977); see also Hamill, *supra* note 3, at 1460.

<sup>5</sup> HAW. REV. STAT. §§ 428-101 to -1302 (1997).

<sup>6</sup> Marcum, *supra* note 1, at 146.

<sup>7</sup> *Id.* at 145.

corporation and the LLC, entrepreneurs can choose to start their business as a sole proprietorship, a general partnership, a limited partnership, or a limited liability partnership.<sup>8</sup> Entrepreneurs, as well as those that advise them, should consider many factors before the entity selection is actually made by the business.<sup>9</sup>

It is widely recognized that states compete for new businesses as a way of increasing state revenues.<sup>10</sup> State revenues have increased due to the LLC registration fees,<sup>11</sup> and some states have chosen to distinguish the LLC fee structure from that of the corporation fees structures in an attempt to increase revenues.<sup>12</sup> Given the current state of the economy and budgetary cutbacks, states are considering new ways to generate revenues, including the creation of new entity formation choices.<sup>13</sup>

To make the selection process somewhat more confusing, the LLC entity formation may also take the form of a “series LLC.” A series LLC statute<sup>14</sup> allows for the establishment of a distinct series or cells that are internally created to form the limited liability company.<sup>15</sup> Each series within the LLC entity has its own independent ownership and management, separate from the others within the same LLC entity.<sup>16</sup> However, there are some uncertain legal areas involving series LLCs.<sup>17</sup> An example of one area of concern is the issue of whether each unit in the series has to file a federal income tax return or whether just one return should be filed for the entire series LLC.<sup>18</sup> While this article recognizes the

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<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> See William Cary, *Corporate Law and Federalism: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974) (according to the author, the state of Delaware, motivated by a desire and need to increase its state revenues, adopted statutes that appealed to most corporate directors who generally decided where to incorporate the business).

<sup>11</sup> Eden S. Blair, Tanya M. Marcum & Fred F. Fry, *The Disproportionate Costs of Forming LLCs vs. Corporations: The Impact on Small Firm Liability Protection*, 20(2) J. SM. BUS. STRATEGY 23 (2009).

<sup>12</sup> See *id.*

<sup>13</sup> Howard M. Friedman, *The Silent LLC Revolution - The Social Cost of Academic Neglect*, 38 CREIGHTON L. REV. 35, 46 (2010) (“In virtually every state, those responsible for drafting and/or enacting LLC legislation cite motives which relate to attracting business and revenue to the state, or avoiding the loss of such business and revenues to other states.”).

<sup>14</sup> See, e.g., DEL. CODE ANN. tit. 6, § 18-215 (2005); 805 ILL. COMP. STAT. 180/37-40 (2010); IOWA CODE § 490A.305 (2009); NEV. REV. STAT. § 86.296 (2009); OKLA. STAT. tit. 18, § 2054.4 (2012); TENN. CODE ANN. § 48-249-309 (2010); UTAH CODE ANN. § 48-2c-606 (2010).

<sup>15</sup> Each series LLC individually owns assets with limited liability protection for the assets, separate from the related series LLCs. Probably most important, any financial losses and liabilities of one of the series LLC entities will not affect any of the other series. The series LLC entity appears to be attractive to a particular set of business circumstances, such as where multiple pieces of real estate are purchased. For a discussion regarding the series LCC as an entity, see Carol R. Goforth, *The Series LLC, and a Series of Difficult Questions*, 60 ARK. L. REV. 385 (2007).

<sup>16</sup> See Goforth, *supra* note 15, at 387.

<sup>17</sup> *Id.* at 401.

<sup>18</sup> *Id.*

uncertainty of the series LLC, the primary focus of this article is on the L3C entity. Is the L3C the next important and valuable label for those for-profit businesses seeking to be recognized as socially or environmentally responsible?

## II. UNDERSTANDING THE L3C AND ITS IMPORTANCE AS A SOCIAL VENTURE

The most recent statutory creation in some states is the low-profit limited liability company, known as the L3C.<sup>19</sup> It is part of the LLC family<sup>20</sup> with the characteristic that it shields its member owners from the financial debts and other liabilities of the entity.<sup>21</sup> The L3C is an entity created with the mission to advance one or more causes that are social or environmental in nature and to allow the entity to earn a profit while engaged in its charitable activities.<sup>22</sup> It is viewed as an entity structure that is an ideal solution for the entrepreneurial, mission-driven social venture.<sup>23</sup>

The state statutes authorizing an L3C entity require that these hybrid entities have a “charitable or educational” purpose or goal, with profits as a secondary motive.<sup>24</sup> This requirement “relates the purpose of the entity to the distribution of profits, as a portion of the profits would be re-distributed to the charitable purpose.”<sup>25</sup> Under most state statutes, the L3C must be organized and operated so that:

1. It significantly furthers the accomplishment of charitable or educational purpose and would not have been formed except to further these purposes;
2. Income production or property appreciation is not a significant purpose; and

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<sup>19</sup> Vermont was the first state to amend its LLC statute to include a L3C variation in 2008. *See* VT. STAT. ANN. tit. 11 § 3001(27) (2010). Since 2008, several additional states have enacted or amended statutes to include the L3C form, including Utah, Michigan, Wyoming, and Illinois. *See* 805 ILL. COMP. STAT. 180/1-26 (2010); MICH. COMP. LAWS § 450.4102(2)(m) (2010); UTAH CODE ANN. §§ 48-2c-102(11), 412 (2010); WYO. STAT. ANN. § 17-15-102(a)(ix) (2010). In addition, two Native American tribes, the Oglala Sioux Tribe and the Crow Indian Nation of Montana, have also approved the L3C. At this time legislation is pending in the following states: Alabama, Arkansas, Arizona, California, Georgia, Hawaii, Iowa, Indiana, Kentucky, Maryland, Massachusetts, Montana, New York, Oklahoma, and Oregon. *See* Laws, Americans for Community Development, available at <http://www.americansforcommunitydevelopment.org/laws.html> (last visited Mar. 14, 2012) (site includes links to each state’s statute enacting L3C laws).

<sup>20</sup> *See* Cody Vitello, *Introducing the Low-Profit Limited Liability Company (L3C): The New Kid on the Block*, 23 LOY. CONSUMER L. REV. 565, 569 (2011).

<sup>21</sup> *Id.*

<sup>22</sup> *Id.* at 565.

<sup>23</sup> *See generally* Dana Brakman Reiser, *The Sustainable Corporation: Benefit Corporations - A Sustainable Form of Organization?*, 46 WAKE FOREST L. REV. 591 (2011).

<sup>24</sup> Vitello, *supra* note 20, at 569.

<sup>25</sup> Heather Sertial, *Hybrid Entities: Distributing Profits with a Purpose*, 17 FORDHAM J. CORP. & FIN. L. 261, 272 (2012).

3. It does not seek to accomplish a political or legislative purpose.<sup>26</sup>

While most states' L3C statutes specifically indicate that the small business must have a charitable or educational purpose, this is generally discussed in the social entrepreneurship literature as being a mission-driven organization.<sup>27</sup> Those who support mission-driven organizations often support the concept of a Triple Bottom Line, which encourages sustainability across three factors: financial, social and environmental.<sup>28</sup> Sustainability can be defined as utilizing resources effectively today to ensure that enough resources will exist to meet future needs.<sup>29</sup> Some view the L3C as the solution to an increasing need for an entity formation that enables profits but also has a primary focus on socially and environmentally sustainable business missions. As consumers and investors have become more environmentally attentive, so too has the need for more environmentally friendly products.<sup>30</sup> While the initial focus was on environmental sustainability, products and services that meet a socially sustainable mission are gaining greater attention.<sup>31</sup> Social sustainability focuses on issues related to people and can include meeting basic needs, such as food, health care, and shelter, improving well-being, providing educational or career development opportunities, or protecting a disadvantaged group's access to freedoms or civil rights.<sup>32</sup>

The structure of the L3C permits funding from sources like private firms, nonprofit entities, or the government.<sup>33</sup> More particularly, funding can be sought from foundations, government entities, and nonprofit organizations.<sup>34</sup> The L3C can be viewed as a hybrid social venture—a cross<sup>35</sup> between a for-profit entity and a not-for-profit entity.<sup>36</sup>

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<sup>26</sup> Vitello, *supra* note 20; *see also* I.R.C. § 4944 (2006) (defining program related investments).

<sup>27</sup> *See* James Austin, Jane Wei-Skillern & Howard Stevenson, *Social and Commercial Entrepreneurship: Same, Different, or Both?*, 30 ENTREPRENEURSHIP THEORY & PRAC. 1 (2006).

<sup>28</sup> John Elkington, *Partnerships from Cannibals with Forks: The Triple Bottom Line of 21st-Century Business*, 8 ENVTL. QUALITY MGMT. 37, 37 (1998).

<sup>29</sup> UNITED NATIONS GENERAL ASSEMBLY, REPORT OF THE WORLD COMMISSION ON ENVIRONMENT AND DEVELOPMENT: OUR COMMON FUTURE (1987).

<sup>30</sup> Nina Mazar & Chen-Bo Zhong, *Do Green Products Make Us Better People?*, 21(4) PSY. SCI. 494, 494 (2010).

<sup>31</sup> *See generally* JESSE F. DILLARD, VERONICA DUJON & MARY C. KING, UNDERSTANDING THE SOCIAL DIMENSION OF SUSTAINABILITY (2009).

<sup>32</sup> *See generally id.*

<sup>33</sup> CHRISTOPHER REINHART, LOW PROFIT LIMITED LIABILITY COMPANIES OR L3CS, OLR RESEARCH REPORT (2011), *available at* <http://www.cga.ct.gov/2011/rpt/2011-R-0344.htm>.

<sup>34</sup> *Id.*

<sup>35</sup> Mark R. Krogstad, Note, *Filling the Gap: Addressing the Potential Impact of North Dakota Adopting Legislation Creating a New Entity--The Low Profit Limited Liability Company*, 86 N. DAK. L. REV. 535, 537 (2010) (bridging or filling the gap between profit and not-for-profit entities).

<sup>36</sup> Sertial, *supra* note 25, at 261.

The L3C is an entity that is structured under state business entity statutes to be eligible to accept foundations' Program Related Investments ("PRI") and to allow the foundations to remain tax-exempt organizations.<sup>37</sup> Basically, a PRI is an investment in the form of debt or equity "that enable[s] the foundation to generate a return from the nonprofit entity."<sup>38</sup> As discussed further in the next section of this article, PRIs may potentially be a considerable source of investment capital for the social-oriented business venture.<sup>39</sup>

#### A. *Program Related Investments*

L3Cs could be the perfect vehicle for private foundations to invest in hybrid for-profit/nonprofit social or environmentally sustainable projects. PRIs may help these ventures leverage their resources to eventually become financially sustainable as well. Under the Internal Revenue Code ("IRC"), private foundations are generally required to make prudent investments that will not jeopardize the carrying out of their tax-exempt purposes.<sup>40</sup> However, certain PRIs are not subject to penalties based on what may be viewed as jeopardizing the foundation's investments.<sup>41</sup> "The designation as an L3C is intended to eliminate this risk by labeling these types of companies as presumptively pre-qualified to receive funding from a private foundation."<sup>42</sup> Thus, the L3C designation can be viewed as an entity form that signals to others that it can receive PRIs.

What exactly is a PRI? Foundations may make low-interest loans and equity investments to support various charitable organizations and their activities, as long as the investment is program related.<sup>43</sup> PRIs may take the form of low-interest rate loans,<sup>44</sup> equity investments in projects,<sup>45</sup> and loan guarantees to start-ups,<sup>46</sup> as long as these activities by the foundation relate to the foundation's charitable mission. PRIs are ways for private

<sup>37</sup> Krogstad, *supra* note 35, at 541-42.

<sup>38</sup> Sertial, *supra* note 25, at 281.

<sup>39</sup> Thomas Kelley, *Law and Choice of Entity on the Social Enterprise Frontier*, 84 TUL. L. REV. 337, 355 (2009).

<sup>40</sup> I.R.C. § 4944(c) (2006) (providing for the structure); I.R.C. § 170(c)(2)(B) (2010) (defining a charitable or educational purpose as "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").

<sup>41</sup> I.R.C. § 170(c)(2)(B) (2006).

<sup>42</sup> Christian N. Weiler, *The Low-Profit Limited Liability Company has Arrived in Louisiana*, 59 LA. B. J. 98, 99 (2011).

<sup>43</sup> See I.R.S., Program Related Investments, <http://www.irs.gov/Charities-&-Non-Profits/Private-Foundations/Program-Related-Investments> (last visited Oct. 7, 2012).

<sup>44</sup> Matthew F. Doeringer, *Fostering Social Enterprise: A Historical and International Analysis*, 20 DUKE J. COMP. & INT'L L. 291, 319 (2010).

<sup>45</sup> *Id.*

<sup>46</sup> Dana Brakman Reiser, *The Law of Philanthropy in the Twenty-First Century: An Introduction to the Symposium: I. Governance: Governing and Financing Blended Enterprise*, 85 CHI.-KENT L. REV. 619, 627 (2010) ("An equity tranche of members could be tax-exempt private foundations making program-related investments.").

foundations to assist L3Cs with projects that might otherwise be considered risky, complex, or too small for other investors.<sup>47</sup>

According to the Internal Revenue Service (“IRS”), PRIs are investments in which: (1) the primary purpose is to accomplish one or more of the foundation's exempt purposes; (2) production of income or appreciation of property is not a significant purpose; and (3) influencing legislation or taking part in political campaigns on behalf of candidates is not a purpose.<sup>48</sup> If a private foundation can satisfy these three standards for a PRI, then it can invest in an L3C and expect a return on its investment.<sup>49</sup> The IRS considers all funds paid out as PRIs to be “qualifying distributions,” and, as such, the funds apply towards the requirement that a private foundation must annually spend five percent of their net worth.<sup>50</sup> Private foundations often seek guidance from the IRS to determine whether a proposed PRI to an environmentally/socially beneficial venture qualifies as a risky endeavor.<sup>51</sup> However, the IRS is typically slow in its responses to these private foundations,<sup>52</sup> potentially slowing the flow of money into the L3C and its activities.

Any private foundation that is considering making a PRI in an L3C must analyze whether such an investment qualifies as a PRI. However, since the L3C will have one or more exempt purposes, it should be a more straightforward determination for the foundation to determine whether the investment will further its own exempt purposes in an appropriate manner.<sup>53</sup> When making a PRI, the private foundation must receive a signed, written commitment from the L3C entity (or any recipient entity) that the entity will use all of the funds received or return them to the foundation; provide annual financial reports to the foundation; keep books and records available for review by the foundation; and not use the funds for an ineligible purpose.<sup>54</sup>

As a possible solution to the problem of determining whether a PRI can be made to an L3C, Representatives Aaron Shock of Illinois and Jared Polis of Colorado introduced bipartisan federal legislation called the Philanthropic Facilitation Act of 2011.<sup>55</sup> This legislation attempts to reduce the complexity associated with the PRI to “provide unique

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<sup>47</sup> See Doeringer, *supra* note 44, at 316.

<sup>48</sup> See I.R.S., *supra* note 43.

<sup>49</sup> For a discussion regarding social enterprises, see Robert A. Wexler, *Social Enterprise: A Legal Context*, 54 EXEMPT ORG. TAX REV. 233 (2006) (discussing the complex legal issues facing hybrid social enterprises).

<sup>50</sup> I.R.C. § 4942(g) (2007).

<sup>51</sup> Kelley, *supra* note 39, at 356.

<sup>52</sup> *Id.* (An I.R.S. determination “can take up to eighteen months to be processed with no guarantee of a positive outcome.”).

<sup>53</sup> See *supra* notes 37-42 and accompanying text.

<sup>54</sup> I.R.S., Terms of Program-Related Investments: Private Foundation Expenditure Responsibility, <http://www.irs.gov/Charities-&-Non-Profits/Private-Foundations/Terms-of-Program-Related-Investments:-Private-Foundation-Expenditure-Responsibility> (last visited Oct. 7, 2012).

<sup>55</sup> H.R. 3420, 112th Cong. (1st Sess. 2011).

ways to stimulate economic growth while furthering social missions<sup>56</sup> within local communities. The proposed federal legislation seeks to make the IRS private letter ruling friendlier to foundations seeking IRS guidance prior to providing funds to an L3C.<sup>57</sup> If passed in its present form, the proposed legislation would provide L3Cs a process in which to register with the IRS.<sup>58</sup> It would also mandate the filing of annual information returns by the L3C regarding the use of any PRI funds it receives.<sup>59</sup> While this federal legislation is not necessary to the L3C entity, it would give private foundations considering making a PRI in an L3C a straightforward process for determining whether their investment would qualify as a PRI.<sup>60</sup>

### B. *Reasons to Be an L3C*

The L3C was created by proactive states as a means of allowing social enterprises to enhance public, consumer, and investor awareness. It is important for the L3C to take the next step to make others aware of who they are, what they propose to do, and what they need in order to fulfill their social mission—a plan for brand awareness. If effectively marketed, the L3C entity may signal to consumers that it is eligible to receive PRIs, and, consequently, is contributing to a charitable or educational good in which the consumer also has an interest. Each L3C should make stakeholders aware that it is different than a corporation or a non-profit because of its social responsibilities.<sup>61</sup> Accordingly, this effort may increase the chance that a private foundation will become more aware of the L3C and offer a PRI to the particular social venture.

While most for-profit firms have a priority to maximize shareholder wealth, L3Cs can focus on their social or environmental mission to the detriment of their financial mission.<sup>62</sup> This may be perceived as a key advantage over other for-profit entities<sup>63</sup> because

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<sup>56</sup> Press Release, Council on Foundations, Americans for Community Development Applaud Reps. Shock and Polis for Introducing Philanthropic Facilitation Act (Nov. 15, 2011), *available at* <http://www.cof.org/about/newsroom/prdetail.cfm?ItemNumber=18424&navItemNumber=14847> (last visited Oct. 7, 2012).

<sup>57</sup> Council on Foundations, *Issue Paper Philanthropic Facilitation Act*, *available at* [http://www.cof.org/files/Bamboo/programsandservices/publicpolicy/documents/philanthropic\\_facilitation\\_act\\_092011.pdf](http://www.cof.org/files/Bamboo/programsandservices/publicpolicy/documents/philanthropic_facilitation_act_092011.pdf) (last visited Oct. 7, 2012) (stating that one of the purposes of the proposed Act is to provide transparency and to encourage prompt IRS responses).

<sup>58</sup> Elizabeth Carrott Minnigh, *Adding Another Trick to Your Bag of Tricks*, Law for Change, *available at* <http://www.lawforchange.org/NewsBot.asp?MODE=VIEW&ID=3922> (last visited Mar. 6, 2012) (the author is the drafter of the Philanthropic Facilitation Act).

<sup>59</sup> *Id.*

<sup>60</sup> *Id.*

<sup>61</sup> Kelley, *supra* note 39, at 361.

<sup>62</sup> See John Tyler, *Symposium: Corporate Creativity: The Vermont L3C & Other Developments in Social Entrepreneurship: Negating the Legal Problem of Having "Two Masters": A Framework for L3C Fiduciary Duties and Accountability*, 35 VT. L. REV. 117, 117 (2010).

social businesses that take non-L3C forms may be in a constant struggle to pursue their social or environmental mission without compromising their financial profits.<sup>64</sup> The L3C entity may be more flexible than an I.R.C. § 501(c)(3) tax-exempt charitable organization because the L3C can operate a business with not only an environmental, charitable or sustainable purpose, but also be profitable while doing so.<sup>65</sup> Thus, L3Cs are not required to spend a great deal of time fundraising nor do they have to deal with the complicated paperwork and auditing process for a 501(c)(3).<sup>66</sup> Although nonprofit organizations can earn profits, how these profits are earned and spent is highly regulated.<sup>67</sup> Foundations are discouraged from investing money in a way that could be considered as jeopardizing their exempt purpose by IRS excise taxes.<sup>68</sup> Ultimately, the L3C entity can accept these funds as potential PRIs that fit the charitable tax-exempt purpose of the foundations.

L3C statutes vary slightly from state to state.<sup>69</sup> Of the nine states and two Native American Tribes currently with L3C regulations, at least six of those states mandate that the state's Secretary of State is responsible for receiving the L3C filing or registration requirements, thus creating some authority over the L3C entity in some way.<sup>70</sup> Alternatively, Michigan's L3C statute vests the authority in the Department of Licensing and Regulatory Affairs,<sup>71</sup> while Utah vests authority in the Department of Commerce, Division of Corporations and Commercial Codes.<sup>72</sup>

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<sup>63</sup> However, there is considerable debate, at least with respect to closely-held entities, as to whether special business forms such as the L3C are really necessary to produce this advantage. Opponents argue that an LLC or a corporation could serve the same purpose as long as the mission discloses the social goals to any potential investors. See Daniel S. Kleinberger, *A Myth Deconstructed: The "Emperor's New Clothes" on the Low-Profit Limited Liability Company*, 35 DEL. J. CORP L. 879 (2010).

<sup>64</sup> See Tyler, *supra* note 62, at 127-28.

<sup>65</sup> See Doeringer, *supra* note 44, at 297-98 (stating the requirements under the I.R.C. for an entity to be considered a 501(c)(3) charitable organization and why the hybrid L3C may be a better entity for a social enterprise).

<sup>66</sup> See generally Krogstad, *supra*, note 35.

<sup>67</sup> See I.R.S., Publication 557: Tax Exempt Status for Your Organization (Oct. 2011), available at <http://www.irs.gov/pub/irs-pdf/p557.pdf> (last visited Oct. 8, 2012).

<sup>68</sup> Krogstad, *supra* note 35, at 541.

<sup>69</sup> See, e.g., MICH. COMP. LAWS § 450.4102(2)(m) (2010); UTAH CODE ANN. §§ 48-2c-102(11), 412 (2010).

<sup>70</sup> 805 ILL. COMP. STAT. 180/1-26, 180/5-5 (2012); LA. REV. STAT. ANN. § 12:1302, 1304 (2011); MD. CODE ANN., CORPS. & ASS'NS § 5-6C-03 (2011) (naming such entity a benefit corporation); N.C. GEN. STAT. ANN. § 57C-2-20 (2012); R.I. GEN. LAWS ANN. § 7-16-76 (2012); WYO. STAT. ANN. § 17-29-102(ix) (2010).

<sup>71</sup> MICH. COMP. LAWS § 450.4104 (2009).

<sup>72</sup> UTAH CODE ANN. § 48-2c-412 (2010).

### III. SIGNALS: L3C AS A BRAND

The authors argue that the L3C identification might act as an easily identifiable brand element for mission-driven organizations, attractive to both potential customers and investors. A brand is defined as the set of positive and negative attributes that people associate with an organization.<sup>73</sup> Positive attributes of a brand might include trustworthiness, innovation, or dependability, while negative attributes include unreliability or arrogance.<sup>74</sup> More specifically, positive attributes related to social or environmental concerns could include the organization's perceived treatment of its employees or sustainability initiatives. Negative attributes could include the perception of pollution or using child labor. Thus, in essence, a brand is the reputation of a firm, and it can lead consumers toward the business or cause them to shy away from it.<sup>75</sup> Consumers perceive that a good brand is a guarantee about the quality of the business or its products or services.<sup>76</sup> A company trademark, such as a logo, slogan, product, service, or company name, often identifies a brand.<sup>77</sup> A positive brand image is a valuable asset to a firm, and many larger firms have staff devoted to brand management.<sup>78</sup> Price, quality, convenience, and brand familiarity are common factors consumers consider when making purchase decisions.<sup>79</sup>

A brand is developed over time.<sup>80</sup> As the L3C is a relatively new entity, most organizations forming as an L3C will likely be young, entrepreneurial ventures.<sup>81</sup> Generally, however, startups have not had the requisite time to fully develop a brand reputation, so they may lack a perception of legitimacy.<sup>82</sup> This perception may in turn cause stakeholders to be wary of investing in young firms, since potential customers or investors are unaware of the reputation of the business or the quality and value of its products and services.<sup>83</sup> Without an established track record for the company, both consumers and other stakeholders have little

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<sup>73</sup> BRUCE R. BARRINGER & DUANE IRELAND, *ENTREPRENEURSHIP: SUCCESSFULLY LAUNCHING NEW VENTURES* 362 (4th ed. 2011).

<sup>74</sup> *Id.*

<sup>75</sup> *See id.*

<sup>76</sup> *See id.* at 367.

<sup>77</sup> Leslie de Chernatony, *Brand Management Through Narrowing the Gap Between Brand Identity and Brand Reputation*, 15 J. MARKETING MANAGEMENT 157 (1999).

<sup>78</sup> Barringer, *supra* note 73.

<sup>79</sup> Patrick De Pelsmacker, Liesbeth Driesen & Glenn Rayp, *Do Consumers Care about Ethics? Willingness to Pay for Fair-Trade Coffee*, 39 J. CONSUMER AFFAIRS 363, 364 (2005).

<sup>80</sup> *See* Brian G. Nagy, Eden S. Blair & Franz T. Lohrke, *Developing a Scale to Measure Liabilities and Assets of Newness after Start-up*, INT'L ENTREPRENEURSHIP & MGMT. J. 3-9(2012), available at <http://link.springer.com/article/10.1007/s11365-012-0219-2?null>.

<sup>81</sup> *Id.*

<sup>82</sup> *Id.*

<sup>83</sup> *Id.*

means of knowing whether a company will live up to its business, ethical, and customer service promises.<sup>84</sup>

Brand recognition may especially matter for an organization that purports to have a social or charitable mission, such as an L3C. The L3C entity might identify a firm as one that follows sustainable practices in the venture's early stages. After all, given their relative infancy, new mission-driven entities can provide little evidence to consumers and investors about whether they truly meet social or environmental sustainability goals or are just "greenwashing," a public relations tactic in which companies attempt to convince stakeholders that social and environmental goals are being met by misrepresenting minor efforts as something that will have major impact.<sup>85</sup>

Without question, environmental and/or social sustainability is a concern for many consumers.<sup>86</sup> A central concern of such consumers is whether an organization and its products or services are ethical and sustainable.<sup>87</sup> A consumer exhibits such concerns by directing her consumption toward ethical and sustainable products and services that are made or provided by businesses that are socially aware.<sup>88</sup> However, consumers often find it difficult to find accurate information about whether the business and its products or services actually satisfy social or environmental standards.<sup>89</sup>

An L3C designation would signal to consumers that the venture has verified with the state that the entity does meet an approved charitable or educational purpose.<sup>90</sup> When a business has an L3C designation following its business name, the perception that the business meets a social cause may well sway customers to purchase the goods or services from the L3C instead of from non-L3C competitors. For a startup venture, the designation could quickly establish a reputation that would otherwise not exist due to the firm's lack of experience in the market. As customers begin to equate L3Cs with social good, they may be more likely to purchase from an L3C, even when the business is young and has yet to establish its reputation in other ways.

Additionally, the oversight of an L3C by a state agency suggests that the L3C has complied with state requirements and may be a signal to consumers, investors, and, more

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<sup>84</sup> *Id.*

<sup>85</sup> See William S. Laufer, *Social Accountability and Corporate Greenwashing*, 43 J. BUS. ETHICS 253, 255-58 (2003).

<sup>86</sup> See De Pelsmacker, *supra* note 79, at 363-64.

<sup>87</sup> Usama Awan, *Green Marketing: Marketing Strategies for the Swedish Energy Companies*, 1 INT'L J. OF INDUSTRIAL MARKETING 1 (2011).

<sup>88</sup> See De Pelsmacker, *supra* note 79, at 363-64.

<sup>89</sup> Sandro Castaldo, Francesco Perrini, Nicola Misani, & Antonio Tencati, *The Missing Link Between Corporate Social Responsibility and Consumer Trust: The Case of Fair Trade Products*, 84 J. BUS. ETHICS 1, 5 (2009).

<sup>90</sup> See Cody Vitello, *Introducing the Low-Profit Limited Liability Company (L3C): The New Kid on the Block*, 23 LOY. CONSUMER L. REV. 565, 569 (2011).

importantly, private foundations with money to invest.<sup>91</sup> With proper education from the L3C to its stakeholders regarding what the entity represents, investors might come to view the L3C designation as a “stamp of approval,” much like the Good Housekeeping Seal of Approval, Underwriters Laboratory (UL) certification,<sup>92</sup> or a Leadership in Energy and Environmental Design (LEED) Certification.<sup>93</sup> The L3C designation following the name could generate positive brand identification for potential stakeholders seeking businesses focused on social and charitable purposes.

#### IV. SOCIAL BRANDING EFFECTIVENESS

The marketing literature has examined the issue of social branding, focusing primarily on environmental (or “green”) or ethical marketing, for about 20 years.<sup>94</sup> This research has yielded mixed results. Some research indicates that although consumers perceive that their purchases are influenced by ethical concerns, their actual behavior—as tested by several models of ethical consumption behavior—is not.<sup>95</sup> Many environmental or socially sustainable products and services cost more than their conventional counterparts.<sup>96</sup> Thus, the average consumer might express concern for a social issue but ultimately will be influenced by price over these other attributes.<sup>97</sup> However, other research suggests that marketing techniques that focus on ethical, social or environmental products do matter to consumers who prioritize environmental issues and involvement.<sup>98</sup> Additional research shows that these customers are willing to pay a premium for products that promise to improve environmental sustainability, such as through reduced carbon and water consumption or use of less packaging.<sup>99</sup> Green buyers, according to another study, are more likely to purchase products that match their peer group’s norms than the average consumer, and they are more likely than non-green buyers to have a strong product preference.<sup>100</sup>

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<sup>91</sup> At this time, there is little evidence to suggest that state agencies do or do not play an active oversight or investigatory role once an L3C is formed. However, this may have little impact on the perception by the L3C’s stakeholders that it does do oversight.

<sup>92</sup> Underwriters Laboratory, *available at* <http://www.ul.com/global/eng/pages/> (last visited Oct. 14, 2012) (independent product safety certification organization).

<sup>93</sup> *See* U.S. Green Building Council, *What is LEED?*, *available at* <https://new.usgbc.org/leed> (last visited Oct. 14, 2012).

<sup>94</sup> *See* De Pelsmacker, *supra*, note 79, at 364.

<sup>95</sup> *Id.*

<sup>96</sup> *Id.* at 367.

<sup>97</sup> *See id.* at 364.

<sup>98</sup> Melody E. Schuhwerk & Roxanne Lefkoff-Hagius, *Green or Non-Green? Does Type of Appeal Matter When Advertising a Green Product?*, 24 J. ADVERTISING 45, 53 (1995).

<sup>99</sup> Peter R. Tait et al., *Consumer Attitudes Towards Sustainability Attributes on Food Labels*, in AARES NATIONAL CONFERENCE (2011).

<sup>100</sup> Shruti Gupta & Denise T. Ogden, *To Buy or Not to Buy? A Social Dilemma Perspective on Green Buying*, 26 J. CONSUMER MARKETING 376, 386-87 (2009).

While this research is mixed, it does suggest that there is a segment of consumers who will examine the firm, as well as its products and services, to see if they meet the consumers' ethical, social, or environmental standards. This segment is likely to look for brand attributes from the firm, or its products and services to indicate that the firm acts ethically and develops socially and environmentally sustainable products and services.<sup>101</sup> The L3C designation could provide this signal to consumers. Thus, mission-driven ventures might want to seek organizing as an L3C entity if they are trying to attract a certain consumer profile. Branding may be just as important to investors who seek a social return on their investment as to consumers who purchase the goods or services.

## V. THE IMPORTANCE OF SOCIAL BRANDING FOR L3CS

This research suggests that an L3C may be valuable for more than just its legal structure. The authors argue that an L3C entity choice can be used by a new venture for marketing purposes. Once consumers and investors interested in social or environmental sustainability issues become more aware of L3Cs, they are more likely to see these ventures as having positive brand attributes. This brand name recognition may lead to consumers purchasing more of the entity's products as well as investors being more willing to invest in the entity.

### A. *Look Who's Talking Now*

According to statistics compiled by Intersector Partners, L3C, as of March 2012, there are 577 registered L3Cs in the United States.<sup>102</sup> These can be further sub-categorized by state: 185 in Vermont (since April 2008); 126 in Michigan (since January 2009); 37 in Wyoming (since February 2009); 43 in Utah (since March 2009); 1 in the Oglala Sioux Tribe (since July 2009); 87 in Illinois (since January 2010); 35 in North Carolina (since August 2010); 51 in Louisiana (since August 2010); 12 in Maine (since July 2011); and 0 in Rhode Island (effective date of statute is July 2012).<sup>103</sup> In an attempt to understand what the current L3C businesses are doing to communicate their entity's attributes to others, we reviewed the websites, if available, of these existing L3C businesses. We reviewed the websites for several items, including the existence of the designation of L3C as part of the business name, whether the website actively discussed the importance of its business as an L3C, and whether the business was connected to any social media sites.

Our results were informative. One common factor for most of the reviewed websites was that many of the businesses did not attempt to inform the viewer of the L3C entity choice or why the particular business was an L3C. The examination of the websites of

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<sup>101</sup> *Id.* at 289.

<sup>102</sup> *Here's the Latest L3C Tally*, INTERSECTOR PARTNERS, L3C, [http://www.intersectorl3c.com/l3c\\_tally.html](http://www.intersectorl3c.com/l3c_tally.html) (last visited March 14, 2012).

<sup>103</sup> *Id.*

existing L3Cs from the InterSector Partners, L3C database revealed that only a fraction (36.75%) of those with websites educate their consumers on what an L3C is and why it is beneficial.<sup>104</sup> In fact, 31.62% of identified L3Cs with websites do not even state their business entity form, which they are required to do by most states.<sup>105</sup> The following table shows the current use of websites by L3Cs to promote the entity and its mission.

<i>State</i>	<i>No. of L3Cs said to be established<sup>106</sup></i>	<i>No. of L3Cs as identified by Intersector L3C<sup>107</sup></i>	<i>% of identified L3Cs with a website</i>	<i>% websites that state they are an L3C</i>	<i>% of L3Cs that educate or describe what an L3C is on their website</i>
Louisiana	36	0	N/A	N/A	N/A
Illinois	72	57	40.40%	65.22%	30.43%
Maine	5	0	N/A	N/A	N/A
Michigan	108	79	41.80%	66.67%	39.39%
North Carolina	26	19	52.60%	90.00%	50.00%
Utah	38	23	56.50%	69.23%	53.85%
Vermont	176	91	35.20%	59.38%	21.88%
Wyoming	26	22	27.30%	100%	66.67%
Total	487	291	40.21%	68.38%	36.75%

#### B. *Awareness*

The key element needed for an L3C to be considered an effective branding tool is customer awareness of the entity form and what it signifies. Currently, awareness of L3Cs among average Americans is poor.<sup>108</sup> However, some organizations are undertaking efforts

<sup>104</sup> *Id.*

<sup>105</sup> For example, the Illinois statute requires “[t]he name of each limited liability company as set forth in its articles of organization shall contain the terms ... if organized as a low-profit limited liability company under Section 1-26 of this Act, shall contain the term ‘L3C.’” 805 ILL. COMP. STAT. 180/1-10(a) (2010).

<sup>106</sup> INTERSECTOR PARTNERS, *supra* note 113 (Data as of October 10, 2011.).

<sup>107</sup> *Id.*

<sup>108</sup> Even most investors are not aware of the distinction between LLCs and L3Cs. Jeff Trexler, *Illinois Enacts L3C Law*, JUSTMEANS, <http://www.justmeans.com> (last visited Mar. 15, 2012).

to increase consumer awareness of L3Cs.<sup>109</sup> Awareness should rise quickly with the consumers most interested in social and environmental issues.<sup>110</sup>

While a general lack of awareness makes it more difficult for L3Cs to use their entity as a brand attribute, L3Cs can focus their marketing efforts at least partially on educating their consumers about L3Cs. As the marketing research described above suggests, those consumers who most identify with groups that are concerned with social and environmental issues are the ones who purchase from firms that are mission-driven.<sup>111</sup> L3Cs can specifically target their advertising dollars towards these target market segments, which is a strategy that may be the most effective use of funds. As seen from the prior table, 59.79% of L3Cs that we identified did not educate or describe the L3C form on their websites and many of those L3Cs did not have a website at all.

## VI. CONCLUSION AND RECOMMENDATIONS FOR THE FUTURE

Attorneys should consider how the general public could become more aware of the L3C as an entity. Additionally, attorneys should assist in making the L3C a recognized form of new business entity formation. As the general public becomes more aware of the L3C as a social-minded entity for a business, the consumer can then make a conscious decision about whether to support these L3C businesses. Ultimately, branding opportunity is limited until general awareness of the L3C form improves. Low public awareness is complicated by the unfamiliarity of professionals with the option to organize as an L3C in some jurisdictions. Attorneys working with new social businesses should consider the advantages of forming as an L3C, which includes increasing brand recognition among like-minded consumers.

States that have enacted or that are in the process of enacting legislation to establish L3Cs can assist in the effort to educate citizens regarding the L3C entity. Additionally, many consumers are already actively engaged in activities focused on environmental awareness, which presents an opportunity to make consumers more aware of the L3C entity form.

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<sup>109</sup> See generally Dana Reiser, *Benefit Corporations – A Sustainable Form of Organization?*, 46 WAKE FOREST L. REV. 591, 623 (2011) (providing that at least one organization has been spreading word to the public).

<sup>110</sup> Organizations that target consumers or businesses interested in sustainability are starting to educate their audience. As an example, GreenBlue, a non-profit dedicated to helping businesses develop more sustainable products has published an article regarding L3Cs on their website. See Ashley Holmes, *L3C: A More Flexible Corporate Model for Social Change*, GREENBLUE, <http://www.greenblue.org/2012/02/l3c-a-more-flexible-corporate-model-for-social-change> (last visited Mar. 15, 2012). See also Jim Witkin, *The L3C: A More Creative Capitalism*, TRIPLE PUNDIT, <http://www.triplepundit.com/2009/01/the-l3c-a-more-creative-capitalism> (last visited Mar. 15, 2012) (news website encouraging its readers to think about the triple bottom line).

<sup>111</sup> Schuhwerk & Lefkoff-Hagius, *supra* note 98.

Attorneys should encourage their L3C clients to use the entity designation as part of their brand. Brand recognition from the L3C name can be a relatively inexpensive way of marketing to social or environmentally-minded consumers. For example, a venture can place its name on LinkedIn's company page or Facebook's business page as "Company X, L3C" and comment in groups or discussions that attract their targeted market segment.<sup>112</sup> With "L3C" in the name, these social businesses may help their target market start associating L3Cs with sustainability.

The future of the L3C will depend upon several factors, including those at the federal and state level. At the federal level, time will reveal whether Congress supports the L3C by the passage of pending legislation like the Philanthropic Facilitation Act of 2011 and whether the IRS will make favorable determinations regarding the L3C and PRIs. At the state level, only a minority of states has enacted L3C statutes, although other states have pending legislation.<sup>113</sup> Those advising businesses about the possibility of selecting the L3C form for a particular social enterprise should also facilitate discussions regarding the branding of their L3C business. The L3C entity is a potentially valuable structure for the organization of a social-conscious entrepreneur, as well as a valuable and relatively inexpensive branding tool. Most other for-profit legal entities can find no branding benefit for their potential consumers or investors from their business entity like the L3C designation can provide for the social enterprise.

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<sup>112</sup> For example, Verde Sustainable Solutions, L3C includes the entity in its website URL, *available at* <http://www.verdel3c.com/researchanddevelopment.html>, (last visited Mar. 16, 2012), and on its LinkedIn page, *available at* <http://www.linkedin.com/company/mission-throttle-l3c>, (last visited Mar. 16, 2012). While it does mention what an L3C is in its "About" section, the venture could blog about in on its blog page, and share a link about its blog to groups in LinkedIn interested in energy and efficiency in lighting and appliances. *See About*, VERDE SUSTAINABLE SOLUTIONS, L3C, <http://www.verdel3c.com/aboutus.html> (last visited Mar. 16, 2012).

<sup>113</sup> *See* Gene Takagi & Emily Chan, *The L3C – 3 Years Later*, NONPROFIT LAW BLOG, <http://www.nonprofitlawblog.com/home/2011/08/the-l3c-3-years-later.html> (Aug. 5, 2011, 5:00 EST).