

Comments on the L³C

Arthur Wood

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As we all know delayering cost reducing complexity and transparency is key to growing any market. Indeed at a very simple level all that is occurring is using the same structure that has moved billions of dollars at the federal level for affordable housing and leveraging the concept to philanthropy more broadly - and in the process empowering ordinary Americans within the context of a more efficient and effective social capital market.

Arthur has been one of the key co-developers who has helped shape the L³C into its current form. He is currently developing an entirely new approach to financing the solutions to the world sanitation crisis using the L³C structure.

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The L³C is now on the statute books in the US (and applicable anywhere in the US / Internationally as a US legal entity since it is a variant form of LLC) - the L³C - (A Low profit Limited Liability Company) has passed in six states - Vermont, Michigan, Utah, Wyoming, Illinois, Maine - as well as two first nation jurisdictions - the Crow and the Oglala Sioux and is before another twenty four states at various stages.

The L³C concept was created by Robert Lang, CEO of the Mary Elizabeth & Gordon B. Mannweiler Foundation, who then retained Marc Owens to help convert the idea of a new type of corporate structure into reality. Marc was the Director of the Exempt Organizations Division of the Internal Revenue Service for 10 years before joining the law firm of Caplin & Drysdale. His very significant contribution to the process was to figure out how to make the L³C a variant form of LLC via the definitions route rather than building a more complex parallel form. It made it much easier to pass and for people to grasp.

Having met Robert and Marc at an Aspen event on legal structures in Philanthropy I joined the effort about the same time as a co-developer, and using my banking and social finance background, expanded the financing possibilities.

Comments on the L3C by Arthur Wood continued

A comparable initiative is underway in the UK called the SELLP with the leading UK philanthropic Lawyer Stephen Lloyd in the UK, who wrote the CIC legislation in the UK (and sees the need for an LLC structure) and a former Charity Commissioner Michael Webber. We are also supporting mirrored initiatives in Singapore, the Netherlands, Italy, South Africa, Australia, and Canada.

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At a very simple level it just makes it easier to do PRI's - and the biggest resistance has logically been from a few members of the status quo who benefit out of the existing complexity. This is answered by a very simple anecdote - one of the major foundations with substantive resources took the same time to launch one PRI - as a hundred ordinary Americans were empowered by the L³C in the state of Vermont to launch social ventures based on utilizing the L³C

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Globally it can be argued there are three legal models in play:

1 - Public private partnerships - defined by the rules and processes of government.

2 - Social Company legislation - such as the CIC - passed in the UK and the proposed (but not yet enacted in any states) B Corp and H Corp in the US. Here you change the nature of the objective of the legal entity itself - with multiple stakeholders - to be social - and the definition of social mission becomes key (In the US case by adherence to the constituency rules found in 30 States). It also gets you very quickly into the metrics debate.

3 - The LLC is not a singular entity - each one can be configured for different partners (nonprofits, foundations, corporates, individuals, government agencies, etc.) taking different social economic return for the entity. The critical point is that there is no contradiction between making profit and doing good things - its just the primary objective has to be philanthropic. That philanthropic objective, legal case law and compliance mechanism is already codified at both State and Federal level - since this is pari passu with the PRI Legalisation.

There are clearly advantages and disadvantages of all these models but for the sake of brevity let me focus on the L³C and looking also at its broader ramifications for each of the players - when reading this note it is probably worth bearing in mind that social capital performs two roles - one charitable which will probably require grants and secondly as the R&D of society - where many of these ideas go on to become main stream for profit businesses.

1 - For the corporate world it says you can now engage in developing new markets, creating also access to subsidy, effectively changing the marginal cost of capital, opening up new markets allowing you to position brand, or address environmental concerns. The critical point is you MUST be consistent with Rule 170 of the IRS code - in terms of philanthropic mission.

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2 - For the traditional nonprofit / foundation world - it gives access to these structures at cheap low unit cost (<\$500 to set up)- delaying complexity and increasing transparency - leveraging their power.

3 - Allows a number of players to create systemic partnership (but ring fenced risk per deal) - with the not for profit (R&D integrated into the upstream benefits and cash flow) with goals aligned - as opposed to being stuck in just the grant position.

4 - For the banks it has been written so it is consistent with the 1934 securities act, and ensures cheap and easy replicable structures as well as the opportunity to trade social value and create exit strategies for investors. I also personally believe you could create structures that would allow social value to be traded – removing a major barrier to Investment, namely a lack of exit strategies

5 - For government it brings the tax paying corporate sector into philanthropy - so it is no longer a subsidy argument but revenue neutral to revenue positive focused around the provision of services which is a cost to government. Of course this does not preclude the US Congress, if it was so minded, to specify specific tax credits useable only by the L3C.

6 - For governments such as Singapore (or London / NY) - who have hub strategies, it offers the opportunity to leverage philanthropy in support of their corporate and banking hubs. It creates the potential for regularizing the global philanthropic legal framework - how much quicker will that process be if the countries see philanthropic tax legislation as a source of their own global competitive advantage - i.e. leveraging the Philanthropic R&D?

We do not know the exact number of L³C's that have been created since this legislation was first passed in

April 2008, but my guess is that there must be over 100. The process, of course, will really take off when supporting legislation passes at the Federal level - and any IRS risk goes away. In any event many will be tested this year on submission of the 990 tax return by foundations who have made PRIs into L³Cs or alternatively we find another mechanism to reduce the risk of doing this just with State legislation.

Arthur Wood is an Englishman and former banker married to a Norwegian, educated at the London School of Economics, SDA Bocconi, Italy and HEC in France. As a Leadership Group Member and the former Global Head of Social Financial Services of Ashoka based in Washington DC and then London. His core mission was and remains to see how we can change the way Philanthropy is funded. In this context he has been at the forefront of creating and implementing new Social Financial models with cutting edge global and US social entrepreneurs. As well as engaging a number of major international financial institutions to enter this space in Canada, Switzerland, US, Singapore and the UK. Internationally as one of the co-creators of the new Low Profit Limited Liability (L3C) in the US and the proposed SELLP in the UK he is on the forefront also of the global debate on new legal and tax structures required in philanthropy.

He is the current Chairman of the World Sanitation Financing Facility (WSFF) - in which capacity he has recently moved to Geneva - a Founder Partner of Total Impact Advisers, A member of the World Economic Forum Advisory Group on Social and Philanthropic investing, Board Member of the Big Issue Invest in the UK and sits on the advisory board of a number of social sector entities in a number of international locations. He publishes widely in the business press on social financing issues and is a regular invited speaker at global academic institutions - including Geneva, St Gallen, Oxford, Indian School of Business, Darden and Dartmouth.

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