15.0502.01000

FISCAL NOTE
Requested by Legislative Council
01/20/2015

Bill/Resolution No.: HB 1447

1 A. **State fiscal effect:** *Identify the state fiscal effect and the fiscal effect on agency appropriations compared to funding levels and appropriations anticipated under current law.*

	2013-2015 Biennium		2015-2017 Biennium		2017-2019 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues	$1,000	$0	$1,000	$0	$1,000	$0
Expenditures	$20,000	$0	$0	$0	$0	$0
Appropriations	$0	$0	$0	$0	$0	$0

1 B. **County, city, school district and township fiscal effect:** *Identify the fiscal effect on the appropriate political subdivision.*

	2013-2015 Biennium	2015-2017 Biennium	2017-2019 Biennium
Counties	$0	$0	$0
Cities	$0	$0	$0
School Districts	$0	$0	$0
Townships	$0	$0	$0

2 A. **Bill and fiscal impact summary:** *Provide a brief summary of the measure, including description of the provisions having fiscal impact (limited to 300 characters).*

The bill creates a low-profit limited liability company. The fiscal impact is related to programming this new entity and merging it into the existing limited liability company laws, which this bill proposes.

B. **Fiscal impact sections:** *Identify and provide a brief description of the sections of the measure which have fiscal impact. Include any assumptions and comments relevant to the analysis.*

As stated in 2A, this bill would require special programming to merge it into existing limited liability company laws.

3. **State fiscal effect detail:** *For information shown under state fiscal effect in 1A, please:*

A. **Revenues:** *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*

The agency has no concept as to how many entities would register under this law.

B. **Expenditures:** *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*

The continuing software functionally for the program would be part of the agency's operating budget.

C. **Appropriations:** *Explain the appropriation amounts. Provide detail, when appropriate, for each agency and fund affected. Explain the relationship between the amounts shown for expenditures and appropriations. Indicate whether the appropriation or a part of the appropriation is included in the executive budget or relates to a continuing appropriation.*

None

Name: Al Jaeger
Agency: Secretary of State
Telephone: 701-328-2900
Date Prepared: 01/23/2015

2015 HOUSE INDUSTRY, BUSINESS AND LABOR

HB 1447

2015 HOUSE STANDING COMMITTEE MINUTES

Industry, Business and Labor Committee
Peace Garden Room, State Capitol

HB 1447
1/28/2015
22772

☐ Subcommittee
☐ Conference Committee

Reed Christensen

Explanation or reason for introduction of bill/resolution:

Low-profit limited liability companies and to provide for codification in the event.

Minutes: Attachments #1, #2, #3, #4

Chairman Keiser: Opened the hearing on HB 1447.

Representative Mock: Testified in support of the Bill. (Attachment #1)

Representative Kasper: On page 4, lines 3-7, this seems to be an open door to do anything. How do you explain those lines?

Rep. Mock: The primary responsibility of an L3C is to serve its charitable mission. After that, the profits may be shared among members of the LLC and distributed as they see fit.

Representative Rick C. Becker: Explain what is the difference between an LLC and this L3C? What can't I do with an LLC that I can do with this bill?

Rep. Mock: This allows for more program related investments to be targeted for a social enterprise. This is for social entrepreneurs who would otherwise serve in the non-profit capacity but want to have investments from foundations. An L3C is very similar to an LLC but it pushes its charitable mission before generating a profit.

Representative Becker: Seems that I can do that in the membership agreement. I can say that our prime mission is to provide charitable funds for X, Y, and Z. What am I absolutely unable to do with an LLC that I can do with this new entity?

Rep. Mock: I will find that very answer before the end of this hearing.

Representative Ruby: We passed a public benefit corporation. Will that new structure address the needs of your people in the area? If not, why would this one be better?

Rep. Mock: I prepared a document that explains the difference between an L3C and a public benefit corporation. L3C don't offer the transparencies and legal protection of B corporations, while B corporations will not receive the broad capitol market. (Attachment #2).

Representative Ruby: Would that be because of the transparency? People wanting to give but they don't want to be seen supporting that?

Rep. Mock: I don't think I can properly answer that. B corporations are relatively new. It is common for states to have both L3C's and B Corporations in their LLC code.

Representative Laning: Since this a low profit LLC, does this extend to farmers?

Rep. Mock: Someone else probably has a better answer.

Chairman Keiser: There does appear to be less flexibility and more transparency in the B Corporation. How quickly can you change between L3C and LLC?

Rep. Mock: The L3C can be modified and become an LLC with more ease than a B corporation to an LLC.

Dustin Gawrylow ~ North Dakota Watchdog Network: (Attachment #3).

Representative Ruby: By accessing those funds that are to be used to improve the company. Then the profit would go to a charitable. Does that give them an unfair advantage?

Gawrylow: Yes, it does. That happens already in code.

Representative Hanson: Can the entity that doesn't have those advantages convert?

Gawrylow: I don't know that.

Opposition

Clara Jenkins ~ Behalf of Secretary of State-Al Jaeger: (Attachment #4).

Representative Beadle: If we amend the bill to get it out of the LLC subsection, would you still be opposed to it?

Jenkins: We would not be opposed to it, but will we have enough time before crossover deadline to accomplish it? I think there are some questions related to the non-profit relationship that need to be addressed in this act.

Representative Rick C. Becker: Is it true that the vast majority of LLC's are essentially passed through entities?

Jenkins: Yes, I believe that is true.

Representative Becker: With the new entity, are you still able to pay yourself a salary or bonus?

Jenkins: It's conceivable that it could happen. They would likely be jeopardizing their non-profit status.

Neutral

Tony Weiler: We take no position, it should become a separate. Is Senator Guy willing to work with the committee?

Chairman Keiser: How much work was involved in developing the documentation for the public benefit form?

Jenkins: It took months to develop the documentation, and the fine tuning took weeks.

Chairman Keiser: Closed the hearing.

2015 HOUSE STANDING COMMITTEE MINUTES

Industry, Business and Labor Committee
Peace Garden Room, State Capitol

HB 1447
2/2/2015
22960

☐ Subcommittee
☐ Conference Committee

Reed Christensen

Explanation or reason for introduction of bill/resolution:

Low-profit limited liability companies and to provide for codification in the event.

Minutes:

Chairman Keiser: Opened discussion on HB 1447.

Representative Beadle: Representative Mock was going to try and have an amendment. I will check to see.

Representative Ruby: One thing that the secretary of state, they would much rather see the effort to develop that type of a structure and vet it out.

Representative Beadle: I do know that was a hurdle, he would be willing to get an amendment drafted this session.

Chairman Keiser: The problem I have is the taking of dollars from a tax sheltered organization and giving it the private - public partnerships. I can't support that.

Representative Beadle: Do we want to spend the effort to amend it to be less harmful?

Representative Ruby: There may be more flexibility, but there is less transparency. So we could have the situation of funds being diverted with no way of seeing it.

Chairman Keiser: Well do we want to amend the bill or kill it?

Representative Ruby: Makes Motion for a Do Not Pass recommendation on HB 1447.

Vice Chairman Sukut: Seconds the Motion.

Representative Becker: I'm going to support this motion. I think that the tax sheltered funds is the only thing that makes this bill "special".

Roll Call Vote: 10 Yes, 3 No, 2 Absent.

Motion for a Do Not Pass carries.

Rep Ruby: Carries the Bill

Date: Feb 2

Roll Call Vote: 1

2015 HOUSE STANDING COMMITTEE
ROLL CALL VOTES
BILL/RESOLUTION NO. 1447

House Industry, Business & Labor Committee

☐ Subcommittee ☐ Conference Committee

Amendment LC# or Description:

Recommendation: ☐ Adopt Amendment
☐ Do Pass ☒ Do Not Pass ☐ Without Committee Recommendation
☐ As Amended ☐ Rerefer to Appropriations
Other Actions: ☐ Reconsider ☐

Motion Made By Ruby Seconded By Sukut

Representatives	Yes	No	Representatives	Yes	No
Chairman Keiser	x		Representative Lefor	x	
Vice Chairman Sukut	x		Representative Louser	x	
Representative Beadle		x	Representative Ruby	x	
Representative Becker	x		Represenative Amerman		x
Representative Devlin	x		Representative Boschee	x	
Representative Frantsvog	x		Representative Hanson		x
Representative Kasper	Ab		Representative M Nelson	Ab	
Representative Laning	x				

Total (Yes) 10 No 3

Absent 2

Floor Assignment Rep Ruby

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

HB 1447: Industry, Business and Labor Committee (Rep. Keiser, Chairman) recommends **DO NOT PASS** (10 YEAS, 3 NAYS, 2 ABSENT AND NOT VOTING). HB 1447 was placed on the Eleventh order on the calendar.

2015 TESTIMONY

HB 1447

Rep Mock Jan 28, 2015 HB 1447 1

The L3C or Low-profit Limited Liability Company was created in the mid 2000s by Robert Lang and codified in 2008 when Vermont became the first state to make the L3C part of their Limited Liability Company body of law. The term Low-profit was used since the furtherance of a charitable mission usually requires the entity to sacrifice some portion of the profit. If it could operate at normal profit margins and stil further a charitable purpose it would organize as a regular LLC.

Robert Lang dubbed the L3C "the for profit with the nonprofit soul" since it is a for profit business doing the work of a nonprofit. This means that unlike a nonprofit which normally has to constantly raise money to coverr its losses the L3C, if properly capitalized, while not earning a large profit will earn more than it spends and the mangers can expend 100% of their effort on running the business and 0% of teir time on raising funds.

The L3C was created because there was no form of business organization specifically designed for the carrying out of business intended to provide charitable benefit and to mesh exactly with the IRS definition of PRIs. This was done because in order to meets its goals the L^3C normally needs low cost capital and the investment of PRIs from foundations is one way to get this capital. Well over a thousand L3Cs have been created and are still operating since Vermont passed the first law in 2008. It is now the law in many states and Indian Nations but most importantly like a Delaware corporation the L3C can be used in any state.

The L3C, because of its legal structure, requires the managers to place furthering the charitable mission ahead of earning a profit. However, unlike a nonprofit it leaves the mangers free to make purely business decisions which encourage efficient management and use of capital. The L3C has owners who can earn a return on their share after the mission requirements have been fulfilled. Assets can also be bought and sold as management determines advisable at a loss or gain. L3Cs can be bought and sold and merged. In other words they are a business but one whose reason for being is furtherance of a charitable purpose.

From a management perspective since the L3C is a variant form of LLC the organizers can retain ownership control and never worry about an out of control board that takes them out of the picture. Like any LLC its organizational structure is built around a governing document called an operating agreement and all the owners (called members in an LLC) write the operating agreement as they see fit.

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What is the difference between a *Low-Profit Limited Liability Company* (L3C) and a *Public Benefit Corporation* (B-Corp)

By: interSector Partners, L3C
L3C vs. B-Corps: What is Best for Your Social Venture?
November 1st, 2012

L3C is a newly recognized business entity that allows companies to achieve modest profits while operating under a business model that emphasized impact over profits. L3Cs were specifically designed to help social entrepreneurs raise capital from a much broader range of investors than are typically attracted to traditional NPOs.

L3Cs are structured under a "tranching" system that appeals to investors ranging from risk-averse entities like NGOs to aggressively managed hedge funds. Tranching allows a flexible ownership structure that allocates risk unevenly among its members based on their risk tolerance and ROI requirements. L3Cs will typically offer three levels of tranches designed to accommodate variations in investor needs. The lowest tranch is reserved for contributors like program related investments (PRI) that are willing to be junior claim holders and absorb below market rates. Investors placed in the lowest tranch provide the ability for L3Cs to attract the significant capital needed from larger, profit-driven investors placed in higher tiers. The middle tier, or "mezzanine" tier, provides L3Cs with access to socially conscious investors that consider the realization of social impact a component of their expected ROI and, as such, are willing to accept returns slightly below market rates. Lastly, offers an attractive investment opportunity for endowments and other contributors wishing to fund socially conscious projects while receiving market rate returns. Most importantly, the senior tier allows L3Cs to gather the substantial contributions that are typically unavailable to traditional NPOs.

Under *Treas. Reg. § 1.501(c)(3)*, L3C designated entities must: 1) significantly further the accomplishment of one or more charitable or educational purposes identified under *26 C.F.R. § 170(c)(2)(B)*; 2) have been formed for the purpose of furthering said charitable or educational purposes; 3) not strive for the attainment of revenues or property as their primary purpose; and 4) not be organized to further any legislative or political purposes. Some states have passed legislation recognizing L3Cs and several more are considering following suit. Kentucky and Indiana's state legislature failed to pass L3C bills introduced during each state's 2011 legislative session.

Lastly, it should be noted that L3Cs operate as a "pass through" entity for federal tax purposes, allowing the tax burden to be pass along to its members and paid as personal income tax.

A popular alternative to L3Cs for companies wishing to operate under a standard of social accountability is the increasingly recognized Benefit Corporation. Benefit Corporations are distinct from L3Cs because they are required to operate under specific standards set forth by B-Lab, a non-profit organization founded by Benefit Corporation visionary Jay Gilbert. Benefit

Corporations are required to draft or amend their articles of incorporation to include the following five provisions:

Purpose — shall create general public benefit defined as the material positive impact on society and the environment, as measured by a third party standard shall have the right to name specific public benefit purposes the creation of public benefit is in the best interests of the Benefit Corporation.

Accountability — directors duties are to make decisions in the best interests of the corporation directors and officers shall consider effect of decisions on shareholders and employees, suppliers, customers, community, environment (together the "Stakeholders"). Shall have an independent Benefit Director accountable for statement in annual Benefit Report whether Board acted consistent with obligation to create general and any specific public benefit purposes, and considered effects of decisions on stakeholders.

Transparency — shall publish an annual Benefit Report in accordance with recognized third party standards for defining, reporting, assessing social and environmental performance, including assessment of successes and failures in achieving general and specific public benefit purpose and in considering effects of decisions on stakeholders. Benefit Report delivered to: 1) shareholders; 2) to public website with exclusion of proprietary data; and 3) Secretary of State with exclusion of proprietary data.

Right of Action — only shareholders and directors have right of action. No third party right of action if Benefit Corporation is a subsidiary, >5% owners of parent have right of action. Right of Action can be for 1) violation of or failure to pursue general or specific public benefit; 2) violation of duty or standard of conduct.

Change of Control/Purpose/Structure — shall require 2/3 majority vote.

Companies that operate under these standards are legally protected and obligated to pursue social benefits before profits. This obligation guarantees to investors that management will operate the business in a way that furthers their interest in social improvement.

Until recently, Benefit Corporations were merely voluntary certifications that provided investors peace of mind and a set of standards for management to pursue. This changed in 2010 when the state of Maryland became the first to recognize Benefit Corporations as a designated legal structure, thus conferring legal protection for company officers to make decisions that seek to provide social benefits over profit.

Today, Benefit Corporations are a recognized corporate structure in 10 states and the District of Columbia with an additional 16 states considering similar legislation. Unfortunately, the Kentucky and Indiana legislatures do not have statutes recognizing B-Corp entities or proposals for enactment of such legislation. Companies created in states like Kentucky that do not recognize Benefit Corporations are limited to voluntarily conforming their company to the standards set by B-Lab to receive Benefit Corporation Certification, which is periodically renewed contingent upon the company's conformity with B-Lab standards.

Conversely, businesses created in states that recognize Benefit Companies can register their company as such and must operate in accordance with the state's applicable statute(s). While such legal entities are not required to maintain "Benefit Corporation Certification" from B-Lab *per se*, nearly all require the Benefit Corporation to meet similar third party standards.

While both L3Cs and B-Corps offer solutions important to emerging social entrepreneurs, both designations fail to address the challenges addressed by the other — L3Cs do not offer the transparency and legal protections of B-Corps, while B-Corps will not receive the broad capital market access enjoyed by L3Cs. Ultimately, the decision must be made by weighing the importance of generating capital (L3C) or the legal obligation that demands management make every operating, financing, and investing decision based primarily on pursuit of a social cause (B-Corp).

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HB 1447 – Testimony by Dustin Gawrylow (Lobbyist #244) North Dakota Watchdog Network

Low-Profit LLCs – Could they be part of reforming tax incentives and Public Private Partnerships?

- Ability to take some private foundation funds makes raising private matching funds easier if they can come from a tax-sheltered foundation first.
- Requirement that the entity has a mission can protect taxpayers from enriching developers and providing them with operating capital to do other more profitable work based on the cashflow generated from public contracts.
- Low-Profit LLCs could become their own revolving loan funds, and if structured correctly, and made to be the only suitable vehicle for public funding of social welfare and economic development.

Conclusion: Restricting public investments via tax incentives and subsidies from creating a policy of picking winners and losers is a goal both liberals and conservatives can get behind.

If creating a new business class can pave the way to reforming things like incentives, matching grants, and public private partnerships it is worthy of exploring.

4

ALVIN A. JAEGER
SECRETARY OF STATE

HOME PAGE www.nd.gov/sos

PHONE (701) 328-2900
FAX (701) 328-2992

E-MAIL sos@nd.gov

SECRETARY OF STATE

STATE OF NORTH DAKOTA
600 EAST BOULEVARD AVENUE DEPT 108
BISMARCK ND 58505-0500

January 28, 2015

TO: Representative Kaiser and Members of the House Industry, Business and Labor Committee

FR: Clara Jenkins on behalf of Al Jaeger, Secretary of State

RE: HB 1447 – Relating to Low Profit Limited Liability Companies

The intent of this bill is to merge the proposed low profit limited liability company business structure into the chapter on limited liability companies. On January 26, the House approved the Uniform Limited Liability Act, HB 1136, by a vote of 91 to 1.

However, because of the unique features of this particular type of business structure, it should have its own standalone chapter as exists in state law for all other business entities. It is unwise to blend the legal requirements for a low profit limited liability company with those for a "regular" limited liability company.

For over twenty-two years, on behalf of the Secretary of State, I have collaborated with Fargo attorney, William L. Guy III, on behalf of the North Dakota Bar Association, to carefully develop the various business entity laws over a period of several months into unique chapters specific to each type of entity. Subsequently, these separate chapters of law have been enacted by the legislature creating the limited liability company, the limited liability partnership, the limited liability limited partnership, the nonprofit limited liability company, the publicly traded corporation, a completed rewrite of the nonprofit corporation act, and the public benefit corporation act (passed yesterday by the House on a vote of 87 to 6).

This separation of business entities into separate chapters has proved to be very helpful for citizens, attorneys, accountants, and for the administrative functions of the Secretary of State's office.

It is the position of the Secretary of State's office that the provisions in this bill specific to a low profit LLC are too vague for insertion into the "regular" LLC chapters. For example, a low profit LLC is a hybrid entity between a general business limited liability company and a nonprofit limited liability company. As such, the low profit LLC may obtain funding from nonprofit and government sources. Because of those potential non-typical funding sources, would it be advisable for a low profit LLC to have a greater public disclosure requirement than those of a "regular" limited liability company?

If the primary goal of a low profit LLC is for a stated social mission and profit is a secondary goal, should the articles of organization disclose the social mission? The annual report of the low profit LLC also does not require any disclosure of the social mission or the manner or degree the social mission was achieved. Should the merger and conversion transactions of the general business limited liability company be restricted if the low profit LLC obtained funding from nonprofit and government sources? May the low profit LLC amend to a general business limited liability company if the social mission becomes too burdensome or is not profitable enough to sustain it? Will a nonprofit organization have its tax exempt status jeopardized if it contributed to a low profit LLC that converts to or merges with a business entity?

In other words, to provide a solid legal foundation for a low profit LLC, these questions and the unique features of this type of entity should be addressed in a standalone chapter. It is for those reasons that the Secretary of State requests a do not pass recommendation.