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Impact Investing Issues List for 501(c)(3) Non-profit organizations creating a for-profit legal entity

By Patricia Sulser, Carol Mates, Laura Hills, Barbara Day
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ABOUT THE AUTHORS



Patricia O. Sulser is a lawyer and international development consultant living in Washington, DC. She worked for nearly 30 years with International Finance Corporation, where she specialized in public private partnerships in the infrastructure space with many different kinds of investors and donors, in the emerging markets. Since she left IFC in 2019, she has been working with a number of charitable organizations seeking to leverage their donors' capital with capital from commercial investors to advance their developmental or charitable missions. Prior to IFC, she worked at Shearman & Sterling in New York City, London and Hong Kong.



Carol Mates is an adjunct professor at Georgetown University Law Center in Washington DC. Her legal work includes almost 3 decades at International Finance Corporation, focusing on the legal aspects of project and corporate finance in emerging markets, and then at the USAID Development Credit Authority's partial credit guarantee program (now part of US DFC). Previously, she worked in private law firms in New York City and at a US multinational bank in Boston. She has served on an advisory board of two US law school's international programs and is a frequent speaker on topics on development finance, including project finance, public-private partnerships and private sector finance in emerging markets.



Laura Hills is a founding partner of Hills Stern & Morley LLP, a unique law firm that focuses almost exclusively on investment and development finance in emerging markets. Prior to founding HSM, Ms. Hills spent ten years at OPIC, including as Associate General Counsel for Finance where she served as chief counsel to the Agency for all matters involving the finance program. Following her tenure at OPIC, Ms. Hills sought to create a law firm for investors looking to enter or expand in developing country markets and help them efficiently access bilateral and multilateral resources created to support investment.



Barbara Day serves as counsel at Hills, Stern & Morley LLP, in Washington, DC and as an Adjunct Clinical Assistant Professor and member of the Advisory Board for the University of Michigan Law' School's International Transactions Clinic. Barbara had a 17-year career at the Overseas Private Investment Corporation (now the US International Development Corporation) where she served in a number of legal and non-legal roles. Before joining OPIC in 2000, Barbara was a partner in the law firm Zuckerman, Spaeder LLP, in Washington, DC.

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Executive Summary

Impact investment is popular, and global non-profit organizations committed to sustainable development have enthusiastically jumped on board to seek ways to catalyze private sector capital to advance their missions. One model has been to create a separate, special purpose legal vehicle, capitalized using a “blended finance” structure. Blended finance is the strategic use of catalytic capital from public or philanthropic sources to increase private sector investment in sustainable development (that is, investments that are designed to achieve a particular environmentally and socially sustainable development objective), often in the emerging markets. There are many models for blended finance. The common thread of these structures is that the concessional capital lowers the risk profile of a particular investment (for example, by bearing the first losses of the investment) to attract and provide comfort to commercial capital providers which seek risk-adjusted market returns. It is an important feature of blended finance structures that, while achievement of sustainable development goals is the primary motivating factor, financial returns are expected, with different capital providers having different return expectations and requirements based on their assessment of the risks of the investment and their strategic goals. Targeted returns can range from below market to market rates of returns, depending on the investor’s objectives.

For some non-profits, impact investing and blended finance will be new territory. Leading an effort to mobilize, structure, and effectively manage different sources of funding for a separate commercial venture is a departure from fundraising that is familiar to most non-profits. And the new company (“Newco”) set up to carry out the commercial venture in an emerging market will be in a business that must make a profit. So, Newco must understand all the nuances of its business and have the right people to start up and operate the company and have an effective governance system. In order to preserve its own tax-exempt status, the non-profit must also ensure that Newco is truly independent of the non-profit. Tax-exempt entities investing in Newco will also need to consider the tax consequences to them of their investments in Newco.

U.S. securities laws will also apply to the raising of capital for Newco, and other U.S. and local laws will apply to Newco. And structuring the terms of different types of

capital providers' investments in Newco can be challenging even for a seasoned commercial team.

This Issues List is designed to help the non-profit organization to spot issues and reflect on resource of allocation, including that associated with obtaining timely expert advice, so that the ultimate structure responds to the non-profit's and its for-profit investors' objectives. It is also intended as a checklist of considerations for non-profit advisors who may be less familiar with profit-making businesses and the investors in them. However, with a high-level appreciation of these issues, proper planning and experienced legal, tax and financial advisors, a non-profit organization can successfully advance its mission using a blended finance impact investing structure.

Objective; Scope of Focus and Hypothetical Case Study

As impact investment models gain prominence and the non-profit world seeks ways to leverage support for specific projects in underserved communities and countries, many non-profit organizations are beginning to explore creating separate, special purpose legal vehicles to generate revenues and earn profit in order to complement their developmental or charitable missions. Impact investing and “blended finance” are not new.¹ Impact investing and blended finance have been described in many different ways. In this Issues Note, **impact investing** means an approach to investing that involves the intention to generate positive environmental, social and developmental impact, alongside financial returns. Impact investing can be done in developed world or in the emerging markets.

Blended finance is a structuring approach, rather than an investment approach, instrument, or end solution. This approach allows organizations with different objectives to invest alongside each other while achieving their own objectives (whether financial return, social impact, or a blend of both).² In general, blended finance involves the strategic use of capital from public or philanthropic sources (sometimes called catalytic or patient capital) to catalyze private sector capital investment (often in emerging and frontier markets) to help bridge the gap necessary to achieve sustainable development³ (i.e., development that achieves positive results for investors and also achieves development impact and benefits communities environmentally and socially).

Broadly speaking, in a blended finance structure, the public or philanthropic entities offer concessional capital that lowers the risk profile of a particular investment (often in an unproven market or region) to attract and provide comfort to the more risk-averse private capital providers. This allows both groups of capital providers to pool their resources for a common sustainable developmental objective, while allowing each group to achieve its preferred financial return objectives. ***It is an important feature of blended finance structures that, while achievement of sustainable development goals is the primary motivating factor, financial returns are expected, with different capital providers having different return expectations and requirements based on their assessment of the risks of the investment and their strategic goals.*** It is not necessary for all Newco investors to be “impact investors”. In fact, in many structures, the point of the blending is to create an opening for a senior tier of investment capital that enters solely on commercial principles. The senior investor(s), such as a pension fund, may prefer/seek out investments that have impact, but the decision hinges on financial returns. Targeted returns can range from below market to market rates of returns, depending on the investor’s objectives.

Examples of blended finance structures used to accomplish the objectives vary widely. Several examples of blended finance structures and some blended finance examples (many of which involve financial intermediaries) are provided in **Annex A**.

For some non-profits, impact investing and blended finance will be new territory. Leading an effort to mobilize, structure, and effectively manage different sources of funding for a separate commercial venture is a departure from fundraising that is familiar to most non-profits. For those non-profits considering impact investment and blended finance to expand their missions, this Issues List is designed to facilitate their discussions with legal, tax and financial advisors, and their accountants, so that they can design a vehicle that achieves their objectives.

For simplicity, the Issues List focuses on the non-profit organization that is both founder and sponsor or lead of the proposed venture and establishes a new legal vehicle to carry out the activity. It does not focus on all the issues that would be relevant to a structure in which the non-profit organization establishes or participates as an investor in an “impact fund”, structures in which the non-profit directly or indirectly manages assets and deploys funds on behalf of impact investors it has identified and recruited, or on other impact investing and blended finance structures. However, most of the issues in this Issues List are also relevant to these structures as well. The Issues list outlines high level commercial and related legal issues that non-profit organizations and their advisors should consider. It is designed to help them spot issues and reflect on resource of allocation, including that associated with obtaining timely expert advice, so that the ultimate structure responds to the non-profit’s mission without jeopardizing the macro interests of the organization or exposing it (or its investors) to unanticipated risks and liabilities.

The types and levels of professional expertise that are relevant to the non-profit organization will depend on the situation but can include: (i) tax advice in all relevant jurisdictions, and expertise in cross-border taxation; (ii) advice from professionals who specialize in tax-exempt organizations embarking on commercial endeavors; (iii) accounting, finance, operational, and Human Resources (to address culture change at all levels); and (iv) U.S. and local counsel with experience with corporate and securities laws and transactional work in multiple jurisdictions, foreign currency issues, and the proposed legal and regulatory requirements for the particular business. In short, a non-profit organization should engage a firm and legal team with deep experience in these areas of expertise and especially in putting together a transaction like the one the non-profit envisages.

The following case study is illustrative.

Hypothetical Case Study

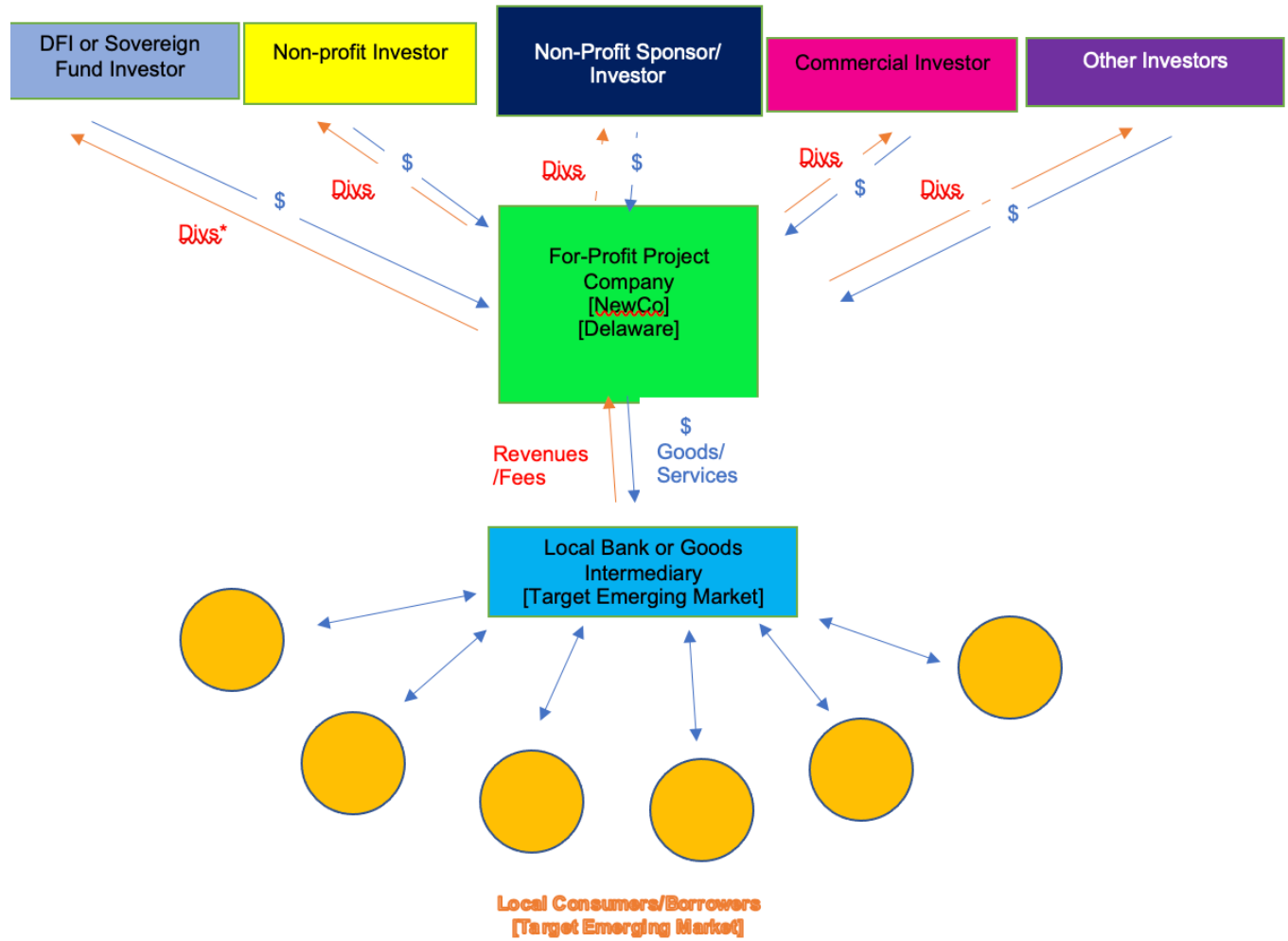
A global U.S. tax-exempt non-profit organization has an overarching mission to address climate change impacts. It believes that a particular emerging market has excellent solar irradiation and that selling solar panels to local consumers would be a viable

business, even a profitable business, with developmental, environmental and social impact. Therefore, this non-profit organization has determined that it can advance its mission by selling solar panels to local consumers (potentially through a local intermediary) or by supporting and catalyzing local bank financing to consumers for these purchases by making capital available to local banks in the form of loans or guarantees.

To do this, the global non-profit organization will form a new for-profit company. The new company will be structured using blended finance: a combination of development finance and U.S. philanthropic funds with private commercial capital. The investors in the new company will make their contributions in the form of equity (i.e., purchasing shares of stock or membership units) or quasi-equity (e.g., convertible, participating or subordinated loans or notes, or potentially in the form of preferred shares). Some prospective investors are willing to assume a higher risk of repayment or returns than other investors. Because many U.S. and international organizations are familiar with U.S. law and prefer predictability in how they will enforce their rights and remedies, for this example Newco is being formed in Delaware.

By implementing this blended finance structure, the non-profit organization and investors in the for-profit new legal entity seek to recover their original investments in the new company together with a return.

Below is a diagram of the simple structure outlined in this Issues List. (“Divs” means dividends but could also include interest or other compensation for quasi-equity investments).



* Divs = Dividends>Returns

Key Assumptions based on Case Study

The following key assumptions are derived from the above Case Study and drive the discussion in this Issues List.

- The sponsoring entity is a public charity, a U.S. 501(c)(3) tax-exempt, non-profit organization (the “**Non-Profit Sponsor**”) established in a jurisdiction in the United States and operating globally.
- Non-Profit Sponsor has established or plans to establish and invest in a new legal entity that is organized under Delaware law (“**Newco**”).
- Newco will operate as a single-purpose business directly providing goods or services in an emerging market. Newco will not be a holding company that invests in one or more downstream subsidiaries.
- Newco seeks to generate revenues and profits.
- Non-Profit Sponsor intends to invite its traditional donors and other foundations and donors, sovereign wealth funds, development finance institutions, as well as commercial and institutional investors (or a combination of these) to invest in capital to Newco in the form of equity (*i.e.*, shares or stock) or quasi-equity instruments (*e.g.*, convertible, participating or subordinated loans or notes).
- Newco’s investors include investors that are investing with the primary purpose to promote sustainable development, while also seeking returns on their investments. Other investors are impact investors, but their decision to invest hinges on Newco’s projected financial returns. Newco investors have a range of targeted rates of return.
- Non-Profit Sponsor is pursuing the Newco initiative because it believes that by using a “blended finance” structure, Newco will be able to reach a market that may be perceived as not otherwise commercially viable or that has not yet been proven to be financially sustainable.
- Non-Profit Sponsor and each other non-profit investor in Newco’s capital wish to maintain their respective non-profit character and their tax-exempt status.
- Non-Profit Sponsor does not want to register Newco’s shares of stock, notes or other securities on any securities exchange.

Fundraising and development activities of a non-profit organization are quite different from raising capital for and operating a for-profit business. In the latter, capital contributors have an expectation of generating a profit. Failure to recognize this difference can introduce new legal and other risks to the non-profit sponsor or lead organization. Properly identified and analyzed, these risks can be managed.

This Issues List is organized in three main sections: I) Commercial and Development Issues, II) Legal Issues and III) Structuring and Related Issues. Each section includes issues that a Non-Profit Sponsor should ask itself and discuss with skilled professional advisors. Certain issues are relevant to or overlap with multiple topics. Therefore, these issues may be included in multiple relevant topics. Moreover, many issues and topics and solutions are interrelated, not discrete, and should be considered together.

I. Commercial Considerations

A. Non-Profit Sponsor's Objective in Forming and Operating For-Profit Newco

1. Why is Non-Profit Sponsor forming a for-profit Newco?

Before creating Newco, Non-Profit Sponsor should have clarity on how a for-profit commercial venture will advance Non-Profit Sponsor's mission. Non-Profit Sponsor may be in the business of making grants and accustomed to seeing its mission in terms of charity. Whereas impact investors investing in Newco expect a return on their investment. If Non-Profit Sponsor sees Newco primarily as a way to expand Non-Profit Sponsor's charitable reach rather than as a business venture, then that can inadvertently lead to mixed signals among all stakeholders, including within Non-Profit Sponsor itself. Educating the Non-Profit Sponsor Board and securing the necessary Board approvals for Newco can sometimes be an onerous task. Indeed, lack of clarity on the fundamental purpose of Newco can complicate the question of whether to establish a separate legal entity at all, as well as whether the legal entity should be a non-profit or for-profit entity. And it can complicate the type and location of the for-profit legal entity chosen and the types of investors approached. All of which, ultimately, can increase reputational, commercial, and legal risk to the Non-Profit Sponsor.

2. On what basis has Non-Profit Sponsor concluded that Newco can succeed as a commercial venture?

Does Non-Profit Sponsor have the subject matter, financial, and commercial expertise to evaluate Newco's commercial performance, including taking into account different risk scenarios? Did or should Non-Profit Sponsor outsource the due diligence to subject matter experts? See Section III(A) below for an expanded discussion and examples. These questions are among the issues experienced professional advisors can help Non-Profit Sponsor consider and address.

Who analyzed and did due diligence on the proposed business initiative of Newco? Do the financial projections for Newco take account of the local or regional political, legal, and regulatory context?

Have the assumptions underpinning the financial projections been reviewed and confirmed by independent third parties with subject-matter expertise?

3. Who will operate and manage Newco’s business?

Creating and maintaining Newco’s legal identity that is separate from Non-Profit Sponsor limits Non-Profit Sponsor’s liability for Newco activities and helps protect Non-Profit Sponsor’s tax-exempt status. Though it may be tempting, Non-Profit Sponsor must not consider the Newco for-profit business to be an integrated part of Non-Profit Sponsor’s main charitable activities. Newco operations cannot effectively be run out of Non-Profit Sponsor without risking reputational, tax, governance, and other repercussions to Non-Profit Sponsor.

As a for-profit venture with third-party investors, Newco will need to recruit staff and have operations, resources, and systems (*e.g.*, accounting and information technology) that are separate and distinct from that of Non-Profit Sponsor. This separation of Non-Profit Sponsor from its new for-profit Newco can require a significant “culture shift” for Non-Profit Sponsor that should be addressed early. It can be tempting for Non-Profit Sponsor to “control” the day-to-day operations and decisions of Newco. But it must not.

See Section III(A) below for an expanded discussion and examples.

4. Will Newco have the resources and expertise required for Newco’s business?

Expertise is critical. The skills that are required to evaluate social impact are not the same as the skills required for investment or operating a business. Newco will need sufficient resources to acquire the expertise necessary to run a commercial venture. How and on what terms will those resources be made available to Newco? Will Newco hire skilled professionals and officers to operate Newco or will it outsource these requirements?

Failure to deliver on promised objectives may affect more than Non-Profit Sponsor’s return on investment. It may also hurt its reputation and relationships with respect to Non-Profit Sponsor’s own donors and to the investors in Newco.

See Section III(A) below for an expanded discussion and examples.

<p>5.</p>	<p>How will Newco’s performance—financial and social mission—and the likelihood of success of investments in Newco be evaluated and by whom?</p> <p>In addition to Newco being able to operate its business from the commercial perspective, Newco will need the full complement of subject matter and financial expertise to evaluate Newco’s performance and the investors’ financial investments. Newco will need to have in place adequate systems, procedures and skilled financial and accounting professionals to be able to validate its financial results and to support its possible approaches to new investors or even potentially to buyers of Newco, as well as to comply with its reporting obligations to its investors. In addition, Newco will need to be fully able to evaluate the performance of its clients and customers from the perspective of its investors’ environmental and social impact requirements.</p>
<p>6.</p>	<p>Is Non-Profit Sponsor able to fund the costs of setting up Newco and attracting investors?</p> <p>In order to attract investors in Newco, Non-Profit Sponsor will have to advance the funds (which can be in the form of shareholder loans to Newco) to pay for lawyers in the United States and the target country and for accounting and financial advisors. Even though Non-Profit Sponsor may ultimately be reimbursed from funds provided by Newco investors or from Newco’s cash flows, upfront cash from Non-Profit Sponsor will pay for these services. This can be costly.</p>

II. Legal Issues

A. Issues Pertaining to Newco's Legal Formation and Business in the Target Emerging Market

Articulating a business objective and defining Newco's role in achieving that objective is the first step for determining the appropriate business structure (e.g., partnership, limited liability company, corporation, etc.) and where it should be established. Articulating that objective also will be important for the purposes of identifying prospective partners and investors. The following questions are interrelated and designed to help suggest an appropriate legal and commercial structure for the initiative.

1. What type of legal entity should Non-Profit Sponsor choose for Newco?

Setting up a new legal entity is an important step for Non-Profit Sponsor to consider, among other things, to ring-fence it from potential liability for Newco's business and to protect its tax-exempt status.

Choice of legal entity and its location of establishment will be a function of a number of considerations. Non-Profit Sponsor should consider for example likely sources of funding for Newco and the location of those investors. Newco's investors may be tax-exempt organizations themselves or may prefer a pass-through tax structure. Newco may need to access debt or equity capital markets in the future. Different legal structures will affect Newco's ability to access those sources.

Other considerations include, for example, (i) set-up costs, (ii) regulatory obligations, (iii) commercial and local legal considerations discussed in this Issues List, (iv) management and governance flexibility, (v) whether the investors require an exit or the right to transfer their interests and (vi) Newco expects to be a single asset vehicle or to replicate or scale up its business. All of these issues should be discussed in detail with legal, tax, exempt-organization and financial advisors, as well as with Newco's accountants. And it is critical to discuss the tradeoffs of one solution or another with investors throughout the process.

2. How will Newco operate its business in the target country?

Investors may feel more comfortable investing in company that is domiciled in a familiar jurisdiction such as Delaware. However, sometimes an offshore vehicle

	<p>may be more advisable, depending on, for example, investor preference (especially international investors), whether the business will operate in multiple jurisdictions, tax and bilateral investment treaties, and the ability to enforce foreign arbitral awards or judgments in the target country. If sales or operations are only in one country, depending on the circumstances, it might be sufficient to operate from offshore (for example, from Delaware) or for the Delaware company to make a direct investment in an in-country subsidiary.</p> <p>To evaluate whether Newco can best fulfill its business objective in the target country from Delaware (or another non-local) jurisdiction as opposed to through a local presence, questions to consider include:</p> <ul style="list-style-type: none"> • Will Newco face practical, commercial, or legal barriers importing goods or services into the target country? • Will Newco be able to repatriate profits from the target country and through what instrument can Newco accomplish that repatriation? If Newco is a foreign company operating in the target country, will Newco face special tax treatment? What are the rules for a foreign company operating in the target country? Do the local laws discriminate against foreign companies? • To effectively serve its clients and customers, a foreign-domiciled Newco may need to establish a local presence. There may be advantages and disadvantages to establishing a branch rather than a local subsidiary. What are the cost and organizational implications of establishing a local presence? Who will handle marketing and servicing? <p>To evaluate these questions, Non-Profit Sponsor should consult with knowledgeable counsel, accountants and tax advisors in the target country to accomplish Newco's objectives.</p>
3.	<p>Other local law considerations for Newco</p> <ul style="list-style-type: none"> • Does the target country consider Newco's business to be a regulated business? • Are there licensing requirements? If so, what fees are associated with those licenses? • Has Newco evaluated the level of political risk in the target country? • Does the target country impose currency restrictions?
4.	<p>Are expectations with regard to timing and expense of launching Newco realistic and made understanding the anticipated risks?</p>

	<p>Minimizing complexity and costs is an important goal in the impact investing space. However, having a realistic budget and timetable are as important to Newco’s financial success as are any other issues. Non-Profit Sponsor should consider the complexity associated with both the creation of Newco and its funding and seek experienced advisors who are knowledgeable, pragmatic, prudent and efficient.</p> <p>Non-Profit Sponsor might consider launching its for-profit venture as a pilot project with only a few commercial entities or foundations as investors. But, deferring consideration of the questions outlined in this Issues List until the next “phase” if the pilot is successful, ultimately can be costly and time-consuming. Non-Profit Sponsor may find its original investors unwilling to revisit legal structures and documentation to accommodate new investors in an expanded initiative or a replication of it.</p>
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B. Tax and Related Issues

<p>1.</p>	<p>Does the relationship between Non-Profit Sponsor and Newco affect Non-Profit Sponsor’s tax-exempt status?</p> <p>U.S. tax laws pertaining to 501(c)(3) and similar tax-exempt organizations are highly technical.⁴ In the Case Study, Non-Profit Sponsor has decided to pursue a for-profit activity to advance its mission. Creating a separate entity (Newco) for that activity can help insulate Non-Profit Sponsor from the risk of losing its tax-exempt status. However, to best manage its risks of unintended tax consequences (i.e., its tax status or taxes on income received from Newco), Non-Profit Sponsor should consult with legal, tax and exempt-organization advisors, and accountants, early in its process to assess the most effective entity structure for Newco.</p> <p><i>a) How could Non-Profit Sponsor’s investment in Newco affect Non-Profit Sponsor’s tax-exempt status?</i></p> <p>The rules around tax-exempt organizations are strict and nuanced. They require experienced advice from lawyers who specialize in exempt organizations and their operations to ensure that the non-profit organization does not inadvertently fall afoul of them.</p> <p>As a 501(c)(3) organization, Non-Profit Sponsor must operate exclusively for its exempt purpose, and none of its earnings may “inure to the benefit of any private persons or shareholders” (see 26 CFR §1.501(c)(3)-1(c)(2)). U.S.</p>
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	<p>Internal Revenue Service (IRS) considers a 501(c)(3) organization to be operated exclusively for exempt purposes only if any benefit to private persons is both qualitatively incidental (a mere byproduct of public benefit) and quantitatively incidental (insubstantial in amount).</p> <p>Newco will be a “private person”. Therefore, Non-Profit Sponsor’s contribution to Newco (whether in the form of cash or in-kind contribution) must be in exchange for something of equal value. Non-Profit Sponsor’s investment in or contribution to Newco could be deemed to be an inappropriate use of Non-Profit Sponsor’s earnings and adversely affect Non-Profit Sponsor’s tax-exempt status if that investment or contribution were to be valued below market (such as below market rent, low interest loans, etc.).</p> <p><i>b) Will the distributions paid to Non-Profit Sponsor by Newco be taxable income?</i></p> <p>There are a number of structures that Non-Profit Sponsor could apply to Newco. Perhaps the two most common for a subsidiary are (i) a “C corporation” and (ii) a limited liability company (LLC).</p> <p>A C corporation is a separate legal entity with its own tax identification number. As a C corporation, Newco will file its own returns, reflecting Newco’s income and expenses. Newco will pay taxes on its income. Income received by Non-Profit Sponsor from Newco in the form of dividends will be treated as passive investment income and in most cases be tax exempt to Non-Profit Sponsor.</p> <p>An LLC, in contrast, is a “pass-through” entity. Therefore, Newco’s income and expenses will appear on Non-Profit Sponsor’s tax return and may be taxed as unrelated business income. The IRS will attribute the activities of Newco to Non-Profit Sponsor to determine whether Non-Profit Sponsor is pursuing its exempt purpose.</p>
<p>2.</p>	<p>What are the U.S. tax implications for tax-exempt investors in Newco?</p> <p>Ultimately, Newco investors must evaluate how U.S. tax laws affect them and whether those laws impose limitations on their ability to invest. Still, as Non-Profit Sponsor considers legal and commercial structures for Newco, it should understand the issues that will be of concern to prospective investors so that it can try to address them proactively.</p>

Like Non-Profit Sponsor, tax-exempt investors will need to consider the questions in Section II (B)(1) above. They may also be subject to limits on profits and distributions payable to them, excess business holding laws, regulations related to “jeopardizing investment”, and other tax laws and regulations.

Newco foreign investment fund investors may be required to comply with the Foreign Account Tax Compliance Act (FATCA) which requires foreign financial institutions to report annually to the IRS information about financial accounts held by U.S. taxpayers or by foreign entities in which U.S. taxpayers hold a substantial ownership interest.

Many private foundations may make profit-seeking investments (such as “program related investments” or “mission related investments”) so long as they comply with detailed IRS guidelines.⁵

Charitable organizations will need to ensure that their investments in Newco comply with the Uniform Prudent Management of Institutional Funds Act (UPMIFA), which governs how certain charitable organizations manage funds donated to them.

3. What are the tax consequences in the target country to Newco?

Taxes and other official charges can significantly affect Newco’s returns. Even without a formal local business presence in the host country, Newco and its advisors will need to analyze the local legal, tax, financial, and accounting requirements and restrictions in the target emerging market.

A strong financial model will address these issues, among others:

- Income taxes or withholding
- Taxes on transfers: does the host country tax repatriation of dividends or interest payments?
- Stamp duties and other charges on documents: Many jurisdictions outside of the United States require “stamping” on contracts or registrations for enforceability. The charge for those stamps can range from *de minimis* to a percentage or more of the total value expressed in the document. Stamp duties are a very common source of surprise for new cross-border investors.
- Franchise taxes: Is there an annual fee that Newco must pay to maintain either its existence (if it is incorporated in the host country) or its ability to do business in the target country?

	<ul style="list-style-type: none"> • Sales tax or value-add tax: If Newco is selling goods or services in the host country, are those sales subject to a sales or value-added tax? How will that tax affect its margins? As a competitive matter, can Newco adjust its sales price so that the consumer covers the additional cost of the tax or will Newco have to reduce its margin? • Employment taxes: If Newco employs people in the local market, what are the tax implications? <p>These questions and the answers will vary by jurisdiction.</p>
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C. U.S. Securities Laws Issues

<p>1.</p>	<p>What type of financial instrument is Newco offering and how is it being offered?</p> <p>The Case Study notes that Non-Profit Sponsor does not want to register Newco’s shares, notes, or other securities, which can be costly and time consuming, but it does want to seek investment from third-party investors. Any entity raising money from third parties must take into account Federal⁶ and State⁷ (often referred to as “blue sky” laws) securities laws and regulations (as well as, potentially, applicable securities laws in other relevant countries). Failure to comply with the U.S. securities laws and the rules and regulations thereunder can result in substantial consequences, including fines and imprisonment. Formal assurances from Newco to prospective investors about the offering are not uncommon before closing of the investment.⁸</p> <p>A number of different securities laws and regulations could apply to Non-Profit Sponsor and Newco. It is important to work closely with experienced corporate counsel to analyze the applicability of these laws and their accompanying regulations to ensure that Non-Profit Sponsor and Newco do not inadvertently fall afoul of them. This is entirely feasible with proper appreciation of the issues and planning.</p> <p>Two of the key relevant laws are summarized in this Section C, but others may also apply.⁹ Broadly speaking, the two key laws relate to (i) the offering of the securities to investors and (ii) the disclosures to investors. They are summarized below.</p> <p>Under the U.S. Securities Act of 1933, as amended (the “Securities Act”), every offer or sale of a security must either be (i) be registered with the Securities and Exchange Commission or (ii) subject to a registration exemption.</p>
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The Securities Act defines a “security” broadly to mean “any note, stock, . . . bond, debenture, evidence of indebtedness, . . . investment contract . . . , or, in general, any interest or instrument commonly known as a “security,” or any certificate of interest or participation in, . . . guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.”¹⁰ The term is also defined in other securities laws, including state laws, and has been interpreted broadly by courts. It is likely that an investment in Newco would be considered a “security” and therefore U.S. securities laws will be applicable.

If certain conditions¹¹ are met, Newco’s offering of its securities may qualify for one or more exemptions to registration. For instance, exemptions may be available depending on various factors including how much capital is being raised, how many investors are involved, and the type of investors involved (for example, whether they are “accredited investors” as defined in the securities laws). Certain exemptions may also impose restrictions on communications about the offered securities and investors’ ability to sell or transfer the exempt securities. Non-Profit Sponsor will want to work with securities counsel to be sure that its offering and Newco’s issuance of securities will meet the requirements of one or more exemptions under the Securities Act and accompanying regulations and also comply with “blue sky” laws.

2. Is Non-Profit Sponsor “promoting” or bringing the activity and opportunity to “investors”?

If Non-Profit Sponsor is or could appear to be promoting the investment in Newco’s securities, and/or charging a fee (or other compensation) for its participation as promoter, advisor, sponsor, majority investor, manager, service provider, or underwriter, Non-Profit Sponsor should seek advice on how best to address any requirements or limitations of the Securities Act and the Securities Exchange Act.¹²

The U.S. Securities and Exchange Act of 1934, as amended (the “**Securities Exchange Act**”) governs marketing and trading in securities already issued and outstanding. It also contains provisions aimed at different participants in the securities market, including brokers, dealers, promoters and others. The activities of certain parties in the transaction could make them subject to registration and regulation under the Exchange Act.¹³ And the consequences of falling afoul of the requirements (including inadvertently) are not trivial.

The activities that constitute “promotion” should be viewed as a continuum depending, among other things, on the nature of the parties and investors involved, the size of the transaction, the nature of the activities and the relative stage of the proposed venture. For example, there may be limited concern if a non-profit organization gathers a group of people from various institutions for early brainstorming on a concept that they hope to turn into an investment structure. As the

contours of the proposed structure evolve and become more defined, the non-profit should pay more attention, especially if, by way of example only, potential deal terms are discussed, a new vehicle has been set up, the non-profit has committed to invest, or the new vehicle's management or a fund manager have been chosen and participate in the meeting.

To be prudent, Non-Profit Sponsor and Newco might wish to seek advice to confirm that they are not inadvertently caught up by these and other securities laws and how to ensure compliance with or exemption from any application of such laws to them.¹⁴

3. Has Newco provided complete disclosure to prospective investors about the Newco investment?

To comply with anti-fraud provisions of the Securities Act, other securities laws and common law anti-fraud provisions, Non-Profit Sponsor must ensure that prospective investors are formally provided with sufficient, complete, and up-to-date information about Newco so that they can make their own, reasoned investment decisions. In particular, the risks of the investment should be fully and accurately disclosed, including any assumptions supporting the financial projections. Disclosures typically are made in the form of an information or offering memorandum (called a private placement memorandum in private placements). Each of the investors is entitled to: (i) receive the same information memorandum, financial projections, and other information; (ii) have the opportunity to ask questions and request further information; and (iii) be provided any additional information or documentation requested and received by any other investor.

It is common these days for information to be provided to prospective investors in the form of "slide decks" and other electronic forms. These slide decks can be useful tools for introducing investors to the basics of the proposed investment. However, counsel should advise whether this format is sufficient on its own, and how it should be coordinated with formal legal disclosures. Regardless of the form of the information provided to Newco investors, Non-Profit Sponsor should carefully manage and control what disclosures and presentations, reports and other information are shared with each investor. While the information memorandum should contain all the information a reasonable investor would need to make an investment decision (including risk factors), it also will include some standard disclaimers of liability for Newco and Non-Profit Sponsor for reliance by investors on the disclosures to make their investment decisions. These disclosures and disclaimers can help to limit (but likely not eliminate)

	<p>Non-Profit Sponsor’s and Newco’s risk of liability. There is common language for this kind of disclaimer that can be tailored for the specifics of the transaction.</p> <p>In addition to taking care in the preparation and disclosure of information to potential investors and adding disclaimer language, Non-Profit Sponsor and Newco should protect themselves contractually from liability for reliance of investors on information provided, prepared or compiled by them and for investors’ investment decisions. This is usually accomplished in the subscription or purchase agreement entered into by the investor with the issuer of the securities (Newco). The subscription/purchase agreement would normally also include representations, warranties and undertakings, some of which, for example, would capture the conditions necessary for an exemption from registration to be relied upon. Neither the disclaimer language in the information memorandum nor the contractual language with Newco investors can protect Newco (and potentially Non-Profit Sponsor) from liability for material misstatements or omissions in the information provided to investors.</p>
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D. Other Legal Compliance	
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1.	<p>Are there other laws and regulations that are relevant?</p> <p>There may be a host of other U.S. and other countries’ laws, regulations and policies with which Newco may need to comply by virtue of the identity of its investors, customers and its cross-border business. For example, Newco is likely to be subject to the U.S. Foreign Corrupt Practices Act (FCPA) or investors’ Know-Your-Customer or similar policies and procedures, such as Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) policies of development financing institutions and other investors. Compliance, where relevant, with the U.S. Department of the Treasury’s Office of Foreign Assets Control (OFAC) regulations and consideration of data privacy laws (generally triggered by any personally identifiable data) should also be considered, given the penalties for violating these laws. With proper planning and establishment of systems or programs, where necessary, these considerations are generally manageable.</p> <p>These are areas that Newco will need to discuss with both its investors and its counsel.</p> <p>In addition, depending on the nature of Newco’s business, Newco may need to comply with local licensing and regulatory requirements, as discussed above.</p>
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III. Structuring and Related Issues

A. Newco's Business and Cash Flows

1. **Does Newco have a sufficient understanding of its line of business and its cash flows and does Newco have the skill sets to deliver?**

Non-Profit Sponsor (its management and staff) must have a detailed understanding of the business it intends for Newco to be in and how that market works, who the customers are, and what products or services are being offered. It must understand the risks to the business and thereby the risk to the Newco investors. And it must describe the business and its risks clearly to Newco investors, or it risks inadvertent misunderstandings, reputational, commercial and potentially legal risks.

In the Case Study above, for example, investing in or operating a solar panel equipment supply business is a different business than investing in or operating a company whose business is to invest in or lend money to a bank which will, in turn, make consumer loans available for the purchase of solar panels. Newco will need to be certain, among many other things, about

- the current demand for its goods or products and the current prices paid by different classes of consumers for the same or competing goods or products, if any;
- who the intended ultimate customers are, *e.g.*, private-sector consumers, commercial or industrial customers, a bank or a state-owned entity;
- the ability and willingness of members of each targeted consumer class to pay for, or borrow money and repay the loans for, the products (some consumers might not be familiar with the idea of credit):
- how the price for Newco's products is set, and whether the prices are market-based or regulated; and
- the local bank's or intermediary's policies and practices in the area of consumer loans or credit to be able to evaluate and manage these issues.

For other types of businesses, Newco might, in addition, need to ask questions around the following:

- where is the market for Newco's goods or services located; is the market dispersed and, if so, how Newco will reach it;

- whether and how to manage any supply chain risks;
- whether there are market disruption risks; and
- whether there are mitigants for these risks (e.g., insurance, strong credit supplier, etc.)

Non-Profit Sponsor must ensure and be satisfied that Newco will have the expertise necessary to be in the business in which it will be engaged. Newco must have the required professional skills (on staff or by contract with service providers) to operate and monitor the business, to manage its relationships with business counterparts and local government, to report to investors, to manage accounting, technical, HR and legal and regulatory issues as they arise. (See Section C below).

2. How will Non-Profit Sponsor ensure that Newco can and will operate independently from Non-Profit Sponsor?

This Issues List assumes that Newco is a separate legal entity, designed to insulate Non-Profit Sponsor and its resources from liability arising out of Newco activities. To preserve that separation between Non-Profit Sponsor and Newco, Newco should be managed and operated separately. It should have its own management and skilled professional staff, separate books and records and information technology systems. There could also be financial (including tax), legal, technical or reputational risk to Non-Profit Sponsor if this separation is not respected.

For all these reasons, it is risky for Non-Profit Sponsor to treat Newco as a kind of business unit of Non-Profit Sponsor's charitable organization or to make any explicit or implicit promises regarding Non-Profit Sponsor's future involvement to Newco investors or Newco's business counterparties, or to raise expectations as to Non-Profit Sponsor's role in Newco's business and its success. Fundamentally, Newco should have its own management and skilled professional staff, separate books and records and information technology systems.

In a commercial venture, a subsidiary or affiliate can and often does contract with the parent for services. In the non-profit world, selling services to a subsidiary or affiliate could be considered inconsistent with the non-profit's charitable mission, and payments from the subsidiary or affiliate may add to its Unrelated Business Income. If there is a desire or need to share costs or resources, it is important to circumscribe and document the arrangements, including appropriate fees, which should be on an arm's-length basis. And Non-Profit Sponsor and Newco must ensure that the corporate and management

structure properly maintains the separation of the two entities. Counsel can advise on what is acceptable and, if so, how to handle these arrangements.

(See Section (C)(1) below regarding Newco's operating and administrative activities).

B. Newco's Capital Structure, Investors and Governance

1. **What financial instruments will Newco investors have - and what is the risk-return calculation for such instruments?**

It is important that Newco investors are provided clarity as to what they are investing in and the nature of their rights and obligations. This includes clarity as to whether there are differences in the rights and obligations of some investors to others, at inception of the investment and later during the course of Newco's operations. Investors may have different levels of risk appetite, along a continuum from equity to debt securities.

- **Equity Shares**

Equity represents an ownership interest in an entity, and as a general matter, is the riskiest investment to a prospective investor. Equity can take different forms; for example, shares in a corporation or membership interests in a limited liability company. As an owner, an equity investor will receive a portion of the entity's profit if things go well (after expenses and taxes of the company are paid and other investors with less risky securities have recovered their capital and any required returns on their capital). At the same time, if things do not go well, the owner can lose all of its investment. Given this high level of risk, equity investors typically expect the highest level of returns on their investment. Equity investors take the "downside risk" of their company not doing well and being unable to pay returns to the equity investors, but they also enjoy "upside benefits" of it doing well. Indeed, the greater the success, the higher returns to equity investors.

- **Debt/Loans/Notes**

Debt is the least risky security to a prospective investor. But lenders and holders of notes and other debt expect to be repaid, on a fixed schedule or date, and usually with interest at some level that the lenders have determined is commensurate with the risk of their investment. Debt is an obligation of the company issuing the debt instruments and must be repaid. Debt instruments often impose restrictive covenants on the borrower/issuer, which can include default standards for financial and

operational performance, reporting, leverage, litigation or regulatory compliance, and governance requirements. The returns expected by debt investors are lower than the returns expected by equity investors because they are taking less of a risk on being repaid: companies must repay debt before equity can be paid. And, in the event of a bankruptcy of a company, in most legal systems, lenders (or note holders) are paid fully before the shareholders are paid anything. To say this another way, debt has priority over equity. In a straight debt investment, the debt investor takes “downside risk” (the risk of not getting repaid) without any “upside benefit”. Newco can be wildly successful, and the debt investor’s return is unchanged.

- **Grants**

Providers of grants and donations to a charitable organization do not generally have an expectation of getting their money back. Essentially, their contributions to the charitable organization are gifts. In contrast, investors do expect a return of their capital and returns *on* their capital. Some philanthropic donors may be willing to make grant contributions in a blended finance structure specifically to attract and leverage investments by more risk-averse investors. These donors may, for example, bear the first risk of losses suffered by Newco.

In recent years, some charitable and philanthropic organizations have structured their contributions to an impact investment in the form of “recoverable” or “returnable” grants. These are typically structured to be repayable only upon trigger impact events or targets, such as a successful first round of funding that the non-profit sponsor might be helping to get to market, or if the investment vehicle reaches a certain profitability or scale. These types of grants can be an extremely effective way for the charitable or philanthropic organization to support the launch of an impact venture before it is fully structured and launched, as well as an effective way for the grantor to leverage scarce philanthropic funds, to promote mission accountability on the impact venture, and to recycle its funds into other related social enterprises.

The recoverable grant is not (and should not be) structured or characterized as a “repayable” grant. If the grantor requires that all or a part of its grant be repaid, the grant could be considered a loan, albeit a loan with flexible terms. And this may have adverse accounting, tax and/or legal implications for both the grantor and the recipient. This is especially true for U.S. private foundations that intend to provide a grant instead of a program-related investment.

A “forgivable” loan is often considered a type of “conditional grant”. But it is still a form of a loan in which the recipient assumes a debt obligation but, upon meeting certain positive or negative impact targets, it is not

	<p>required to repay principal and/or interest on the loan.</p> <p>Accounting, tax and legal considerations are the primary drivers as to whether to use a recoverable grant or a forgivable loan instrument. For example, in some cases, a funder may only be required by law or its own policies to provide grants, but not loans, or vice versa. Fund recipients may also be restricted from taking on debt.¹⁵</p> <p>For Non-Profit Sponsor, structuring the offering among grants, debt and equity and among equity classes (discussed below) will reflect in part the type of investors Non-Profit Sponsor seeks to and is able to attract and the risk appetite of those investors. Regardless of the structure of the proposed investment opportunity, each of these investors will differ from Non-Profit Sponsor’s typical donor. Donors generally make grants that are essentially gifts. It is important for Non-Profit Sponsor to understand and respect the difference between “investments” in Newco and the grants to Non-Profit Sponsor it is accustomed to dealing with. Investors – even impact investors -- by contrast make investments and expect to see that investment returned.</p>
<p>2.</p>	<p>Will Newco investors all invest on the same terms?</p> <p>In general, the terms on which an investor makes a contribution depends on that investor’s risk appetite as described above. In impact investing, the investor will take into account not only risk but also its impact objective.</p> <p>If Newco investors will all own the same type of security (for example, common shares), there is less likely to be a concern as to any misalignment of the interests among the investors. If, on the other hand, as is often the case in impact investments, some investors are to make grants or to hold equity and others are to hold debt (e.g., loans or notes) which requires repayment, the interests of the investors could diverge. In this case, in addition, Newco could find that it cannot comply with its obligations to repay its debt holders, which could put Newco into default to its debt holders, which could in turn prematurely jeopardize the entire Newco business and thereby the shareholders’ hopes of returns on their investments. In this regard, it is often advantageous to have a strong lead investor with whom to negotiate the terms of investment in Newco.</p> <p>This inherent tension between equity and debt investors is not uncommon or unmanageable in commercial ventures, which often have different types of investors. In the impact investing sphere, too, investors willing to put money into a venture but not to take a high degree of risk may only be willing to come into the opportunity if they do have priority over payments vis a vis other investors. This may be perfectly acceptable to the non-priority class of investors. Indeed, one of the objectives of some investors may be to take higher risks than other</p>

investors simply to attract those more risk-averse investors for their common purpose. And yet, some impact investors may require that development or mission objectives must be met, or they must exit the transaction, which can put the investments of the more senior, commercial investors at risk.

There are different types of equity (e.g., common or preferred shares or membership interests), and different types of debt, (e.g., loans, senior and subordinated notes, participating or convertible notes), each with varying tradeoffs in terms of rights, risks and rewards (i.e., expected returns) and implications for the different investors. For example, some investors may not be willing to fund their contributions at the same time as others, or they may condition their investments on the occurrence or non-occurrence of certain events. Some equity investors may demand that they have a contractual right to exit their investment and the right to freely transfer their interests, if permitted by the applicable securities law (which would restrict transferability of the securities if the initial offering was conducted as a private placement and registration is not contemplated). The right of lenders or noteholders to declare a payment default and the timing and conditionality of funding by different classes of investors are examples of risks to Newco investors vis a vis one another. These risks can also dramatically affect Newco in terms of its ability to conduct its business and perform its contractual obligations to business counterparties.

These rather more complex structures are not unusual in the impact investing space inasmuch as Newco may find that it needs to offer special rights to certain investors to attract their investment in the untested Newco business model.¹⁶ And these differences in the rights and obligations of investors may be acceptable to all the parties.

The key is to be sure that there is disclosure and clarity among all the investors and Newco with regard to the different instruments, and an investors' or shareholders' or similar agreement among Newco and the investors that provides for the rights and obligations of the investors vis a vis Newco, and the investors vis a vis one another. See Section III B(5) for a discussion of other investor issues that should be memorialized in the legal agreement among investors.

3. Do investors have compatible missions, strategies and developmental or impact imperatives?

In addition to the potentially different financial and risk-reward requirements of investors, many investors have their own social and impact objectives and requirements regarding their investments, which may not be entirely compatible. Thus, mission will be an additional due diligence item for Non-Profit Sponsor. Non-Profit Sponsor and Newco will need to understand and assess the

requirements of each prospective investor and determine whether it can accommodate its own and other investors' interests and missions.

For example, private foundations and development finance institutions that are prospective investors may have different requirements or risk appetites. Development finance institutions that focus on the private sector and have a profit objective in addition to their development objectives may, for example, be unaccustomed to investing in a for-profit legal entity set up by a charitable organization. These institutions will need to get comfortable that the for-profit organization's financial projections show a profit in most likely scenarios and that Newco is guided by the principles of operating Newco commercially.

At the same time, assuming Non-Profit Sponsor does not have a controlling interest in Newco (alone or with other like-minded investors) for the reasons outlined in this Issues List, Non-Profit Sponsor may find that its own mission objectives could be compromised at the outset or because of changes in the composition of the investors through introduction of new investors when further capital is raised or by virtue of transfers of interests by investors. One way of locking in mission is to include controls to ensure that any exit by an initial investor will be subject to a protected mission statement in the corporate documents.

Disclosures should go beyond commercial risk (as would be the case in a bottom-line investment) and include a full disclosure of Non-Profit Sponsor's mission/purpose in establishing Newco so that other investors with different missions can evaluate whether that mission interferes with their own objectives. This area can and should be discussed openly among all the stakeholders to avoid any misunderstandings later. A critical goal for Non-Profit Sponsor will be to ensure that the interests of the investor group are aligned—and locked in, through the organizational documents of Newco and a shareholders or investors agreement as discussed in the previous Section.

4. Is Non-Profit Sponsor's role clear; are the arrangements between Newco and Non-Profit Sponsor set out in a contractual agreement?

It is important that Newco exists and operates independently from Non-Profit Sponsor as emphasized in this Issues List. If, having discussed the implications with counsel as suggested in Section III(A)(2) above, Non-Profit Sponsor is nevertheless expected to play a role to provide certain needed services to Newco or to share certain resources, it is important that the terms and conditions of this arrangement be set out in a contract on arm's length terms as between Non-Profit Sponsor and Newco for Non-Profit Sponsor to avoid any raised expectations, misunderstandings and inadvertent liability.

In addition, Non-Profit Sponsor may wish to be explicit in both the information memorandum and in any other documentation to which it is a party with other stakeholders that it is not backing up the obligations of Newco in any way—neither to the investors nor to business counterparties of Newco.

Non-Profit Sponsor may invest in Newco in the form of cash, or in the form of contributions of assets or services, if permitted by the domicile of the for-profit entity. There are likely to be conditions to such forms of contributions, including fair market valuation.

5. What is the composition and role of Newco’s investors and its governance structure?

In addition to the rules set out in Newco’s charter documents, it is important to have a legal agreement among Newco investors, which may be called an investors’ or shareholders’ agreement or similar. This agreement will address, among other things, the commitments of the investors to fund, the process and timing around funding, the composition of Newco’s Board of Directors, voting thresholds and requirements at the Board and investor levels, any undertakings of Newco to the investors (e.g., to report to the investors or to comply with their policies) and any rules around raising additional capital for Newco or selling or transferring their interests. The arrangements also need to describe any priorities among investors affecting funding, distributions, or rights upon liquidation.

This means that it is important to understand and answer the following questions, among others:

Board Composition

- whether Non-Profit Sponsor or another investor effectively controls Newco at the Board, through special approval or veto rights (*NB*: consider too the effect on the objective of maintaining Non-Profit Sponsor’s tax status);
- who will appoint Newco’s directors, and whether each investor will get a seat or possibly more than one seat;
- whether there will be independent directors and, if so, how that director will be chosen; and
- whether some decisions require a unanimous vote of the Board.

Decisions and Voting

- whether Non-Profit Sponsor or another investor effectively controls Newco at the investor level;

- whether all investors have the same requirements vis a vis level of involvement and whether they want to be involved throughout the design, negotiation and operation of Newco (e.g., in voting or consent requirements); and
- whether Non-Profit Sponsor or any other investor requires a veto over certain votes in order to stay true to its mission.

Sharing of Profits

- how profits will be distributed among investors; and
- whether all investors will have *pari passu* (that is, equal) rights or whether some investors will have priority rights, as discussed above.

Many non-profits are “Board managed”. But this is a tough structure for a commercial venture, such as Newco. Boards of for-profit companies have a fiduciary duty to act in the best interests of the shareholders of their company. While a more progressive view of this duty encompasses a duty to a broader range of stakeholders, commercial investors may expect the Board to vote in favor of actions that grow the company and against actions that increase costs or diminish prospects, no matter how much impact those actions might have or how confluent they are with Non-Profit Sponsor's original objectives. This can introduce tensions for a company such as Newco, which has both developmental and financial objectives and some investors whose motivation is primarily driven by the developmental objectives.

“Benefit corporations” are a creature of State law and allow the Board to consider social factors and objectives other than profit to shareholders as equal to or more important than pure return to shareholders. A majority of States have passed benefit corporation laws.¹⁷

It is critical that the investors are broadly aligned on the objectives of Newco and that its organizational and other documents set out clearly how Newco will operate and what its objectives are.

C. Newco's Operational and Administrative Issues

1. Will Newco's governance structure require extraordinary reporting?

Operational and administrative tasks, especially those outside the normal charitable organization's routine, can be surprisingly complex and burdensome. It is important to understand these obligations early on to be able to plan and budget for them, in view of Newco's legal and other commitments, and in view of investors' and business counterparties' expectations. For a discussion on some of the requirements of commercial ventures, see Section I(A)(3).

As "impact investors", Newco investors will be looking for more than financial reporting. Newco should be prepared to measure, track, and report on the developmental, environmental, and social impacts of its activities. For example, foundation and other philanthropic investors are often dedicated to, evaluate and monitor their investments through their own unique lens; for example, resilience, gender, climate change or similar unique thematic issues. Similarly, development finance institutions have requirements of their own that can be burdensome to Newco. For example, development finance institutions require compliance with affirmative and negative covenants, including comprehensive reporting on financial and legal matters, integrity issues, environmental and social aspects of their investments, access to the books and records of their investment vehicle and the business, and disclosures about access to the institution's independent accountability mechanism for project-affected communities. Newco must be prepared to fulfill all of these investors' requirements.

2. What are the accounting and foreign currency considerations for Non-Profit Sponsor and Newco?

As Newco will be operating abroad and investments in Newco are likely to be in U.S. Dollars, it must understand and structure for foreign currency regulations in the target country. For example, Newco will need to ascertain whether foreign (meaning U.S. in this context) currencies can be charged by Newco to its customers, whether foreign currency can be kept in bank accounts locally and abroad, and whether there is unrestricted availability of and right to convert local currency (if relevant) into foreign currency and repatriate the foreign currency.

Depending on Newco's structure and location, Newco may also need to consider how to harmonize local and foreign accounting rules to handle foreign currency as well as other financial reporting issues.

These kinds of issues are manageable if addressed with local and international legal, tax and accounting advisors early on in the transaction. Special care

	<p>should be taken, and time allocated, for “new” emerging markets countries that may not yet have had a great deal of foreign private investment.</p>
<p>D. Key Legal Documentation</p>	
<p>1. Offering document likely to be prepared by Non-Profit Sponsor but, importantly, to be issued by Newco to investors describing the terms for any investment in Newco. This is the information document (sometimes called an offering circular, information memorandum or, in the context of a private placement, a private placement memorandum) that is given to investors and will form the basis on which investors make their investment decision. See Section II(C) for a discussion of the importance of complete and accurate disclosure.</p>	
<p>2. Incorporating agreement (e.g., certificate or articles of incorporation; operating agreement). These are the documents required under Delaware law to form Newco and will describe its purpose and will guide and limit its activities. The form and substance of this agreement depends on the type of legal vehicle chosen for Newco.</p>	
<p>3. Investors’, shareholders or similar agreement creating rights among Newco investors and often also Newco. This is the agreement that will set out the rights and obligations of the investors toward each other, including regarding funding, voting, exiting and generally behaving throughout the investment. See Sections III(B)(2) and III(B)(5).</p>	
<p>4. Purchase, subscription agreement or loan agreement between Newco and its investors. This is the agreement pursuant to which Newco offers, and investors agree to purchase, the securities or make their loans. It will include the commitments of investors and the conditions on which they agree to fund, among other matters. Grant agreements and their terms may also be involved. See Section III(C)(3).</p>	
<p>5. Services agreement, if any, between Non-Profit Sponsor and Newco setting out any services or resources provided by Non-Profit Sponsor to Newco and the fees for such services or resources. See Section III(B)(4).</p>	
<p>6. Commercial or financial agreements between Newco and its clients or customers. This will be a fundamental piece of the picture and establish the rights and obligations of the customer toward Newco, and Newco’s obligations and rights toward the customer. Fundamentally, this document will be the source of revenues to Newco.</p>	

Annex A

Blended Finance Structures and Instruments

Blended finance is not a specific transaction type. It is an approach to structuring that is designed to use concessional or catalytic capital to bear certain risks of a project or investment in order to encourage providers of commercial capital to participate and receive risk-adjusted returns. Below is a short list of the primary ways in which catalytic capital providers may leverage commercial capital. While the list describes structures involving philanthropic entities and development finance institutions as the providers of catalytic capital, there are many other organizations and impact funds that also do so.

- **Technical Assistance** – a philanthropic entity or development finance institution provides, or offers financial support to a party to secure, technical assistance, so that the costs of early preparation or transaction support are not a burden on the project or initiative.
- **Grants** – a philanthropic entity or development finance institution gives money to a party to a transaction to support the early-stage preparation, capital costs or revenue (or viability) gap funding of the project that has no expectation of being repaid. There are hybrids of this instrument called recoverable or returnable grants.
- **Guarantees** – a philanthropic entity or development finance institution offers protection in the form of a guaranty or insurance from certain capital or revenue shortfalls. This kind of support can lower certain political or commercial risks of the project and/or augment the project's credit rating.
- **Equity or Quasi-Equity**– a philanthropic entity or development finance institution buys ownership in the investment or lends money to a project borrower, but accepts a subordinate position in the structure to the providers of other (e.g., commercial) investors so that commercial investors are protected from some risks of the investment. The catalytic capital provider effectively assumes higher risk and/or lower returns of the investment. This is sometimes called “first-loss capital”.
- **Subordinated Debt or Notes**– a philanthropic partner or development finance institution lends to the project on preferential (to the market) or flexible terms that effectively subordinate these lenders' debt to other investors (usually commercial investors) in the project to the debt structure.

Examples of Impact Investing Blended Finance Initiatives

- Global Partnerships
<https://www.convergence.finance/resource/3FMA TirmaI Q4I60CYawU0G/view>
- Habitat for Humanity MicroBuild Project
<https://www.habitat.org/our-work/terwilliger-center-innovation-in-shelter/microbuild>
- International Finance Corporation
<https://www.ifc.org/wps/wcm/connect/b775aee2-dd16-4903-89bc-17876825bad8/IFC+Blended+Finance+Fact+Sheet+%28July+2019%29.pdf?MO D=AJPERES&CVID=mUEEV3E>
- Media Development Investment Fund
<https://www.convergence.finance/resource/6Sr4O5FBxin7Jh5aBXe6nQ/view>
- Medical Credit Fund
<https://www.convergence.finance/resource/3qke8x7gEFCsmKRXi2JD8o/view>
- NatureVest (The Nature Conservancy)
<https://www.nature.org/en-us/about-us/who-we-are/how-we-work/finance-investing/naturevest/>
- WaterEquity.org
<https://waterequity.org>
- The Rockefeller Foundation's Impact Investing Initiative
<https://www.rockefellerfoundation.org/commitment/innovative-finance/>
- U.S. Agency for International Development Investing for Impact
<https://www.usaid.gov/cii/investing-impact>
- WaterCredit Investment Fund 3
<https://www.convergence.finance/resource/4VLkTKyP0IzPzDhp6loqF0/view>
- World Wildlife Fund Impact Ventures
<https://wwf.impacthub.net/story/wwf-impact-ventures/>

ENDNOTES (accessible as of April 9, 2021)

¹ For background reading, see, e.g., the websites of Global Impact Investing Network (<https://thegiin.org>; <https://thegiin.org/blended-finance-working-group>); The Global Steering Group for Impact Investment (GSG), which was established in August 2015 to continue the work of the Social Impact Investment Taskforce established under the UK's presidency of the G8 (<https://gsgii.org/about-us/#aboutgsg>); International Finance Corporation (https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/development+impact/principles; https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/bf); the Organization for Economic Co-Operation and Development (<https://www.oecd.org/dac/financing-sustainable-development/development-finance-topics/social-impact-investment-initiative.htm>; <https://www.oecd.org/dac/financing-sustainable-development/blended-finance-principles>); U.S., Agency for International Development (<https://www.usaid.gov/cii/investing-impact>); and Convergence (<https://www.convergence.finance/blendedfinance>).

² See <https://www.convergence.finance/blended-finance>.

³ See <https://sdgs.un.org/goals>.

⁴ See, e.g., <https://www.irs.gov/charities-non-profits/charitable-organizations/exemption-requirements-501c3>; <https://www.chamberofcommerce.org/tax-information-guide-for-charities-and-non-profits/>.

⁵ See, e.g., <https://www.irs.gov/charities-non-profits/private-foundations/program-related-investments>.

⁶ See <https://www.sec.gov/page/federal-securities-laws?auHash=B8gdTzu6DrpJNvsGIS1-JY1LnXDZQqS-JgJAgaSXimg>; <https://www.investor.gov/introduction-investing/investing-basics/role-sec/laws-govern-securities-industry>.

⁷ Depending on the location of the investors and how and where the offering is being made, Non-Profit Sponsor may need to retain "blue sky" (state securities) counsel or corporate counsel with the capacity to handle the relevant state securities laws. Corporate counsel can advise accordingly.

⁸ Common formal assurances can include various opinions and letters from counsel and accountants, depending on the structure of the transaction and the jurisdictions involved; such as U.S. "no registration" legal opinion, local law opinions, accountants' comfort letters, so-called "10b-5" letters, and due diligence reports.

⁹ For example, the U.S. Investment Company Act of 1940, as amended, requires organizations that have over 100 investors and which are in the business of investing or reinvesting in companies to register and comply with certain reporting obligations, and it restricts the powers of investment companies in corporate governance over management particularly in transactions with affiliates. Although a company (such as Non-Profit Sponsor, Newco or a Newco investor) sees itself as an operating company, its activities and level of control over such activities, the distribution and nature of the assets on its balance sheet, and the nature of the investors (for example, whether they are qualified investors) in the transaction could inadvertently subject them to registration and rather heavy regulation under this Act. Fortunately, there are exemptions that could apply. Experienced corporate counsel can advise on the details of how to manage the entity's activities to comply with or to achieve an exemption from the Act. See <https://www.sec.gov/investment/laws-and-rules>.

¹⁰ The term "security" is defined in Section 2(a)(1) of the Securities Act, Section 3(a)(10) of the Securities Exchange Act of 1934, Section 2(a)(36) of the Investment Company Act of 1940, and Section 202(a)(18) of the Investment Advisers Act of 1940.

¹¹ See, e.g., https://www.sec.gov/oiea/investor-alerts-bulletins/ib_privateplacements.html; www.sec.gov/smallbusiness/exemptofferings; <https://www.sec.gov/news/press-release/2020-273>. The

definition of “accredited investor”, among other terms and provisions, have been updated over the years, including in the Jumpstart our Business Startups Act (the Jobs Act) of 2012 and more recently, and remain relevant. See, e.g., <https://www.sec.gov/news/press-release/2020-191>.

¹² A “promoter” includes “(i) any person who, acting alone or in conjunction with one or more other persons, directly or indirectly takes initiative in founding and organizing the business or enterprise of an issuer; or (ii) any person who, in connection with the founding and organizing of the business or enterprise of an issuer, directly or indirectly receives in consideration of services or property, or both services and property, 10 percent or more of any class of securities of the issuer or 10 percent or more of the proceeds from the sale of any class of such securities....” Securities Act of 1933, Rule 405, 17 C.F.R. § 230.405.

¹³ See <https://www.investor.gov/introduction-investing/investing-basics/role-sec/laws-govern-securities-industry#secexact1934>.

¹⁴ The U.S. Investment Advisers Act of 1940, as amended (the “**Investment Advisers Act**”) may also apply. It stipulates who must register with state and federal regulators for being in the business of promoting or advising on securities investments. The activities of certain parties in the transaction could inadvertently subject them to registration and regulation under the Investment Advisers Act.

¹⁵ Jonathan Ng, *Innovative Finance Focus: Doing More With Less Through Recoverable Grants*, **The National Law Review**, Vol. XI, Number 120 (January 12, 2021): <https://www.natlawreview.com/article/innovative-finance-focus-doing-more-less-through-recoverable-grants> .

¹⁶ It is not uncommon for investors to require that they earn certain financial returns, or that they have guaranteed (or nearly guaranteed) exits to their investments, or transferability of their investment instruments (although securities purchased in a private placement are typically restricted). Some investors might require that they control (or be able to exert negative control through a veto) over Newco through their shareholding or a Board seat. Or investors may require that they have priority over other investors in terms of payments, events of default of Newco or in bankruptcy.

¹⁷ See <https://benefitcorp.net/> ; https://benefitcorp.net/sites/default/files/documents/Implications_of_Becoming_a_DE_Public_Benefit_Corporation_0.pdf .