ESSENTIALS OF BUSINESS LAW

REVIEW OF ENTITY FORMATION AND GOVERNING DOCUMENTS

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April 29 - 30, 2010
Dallas

CHAPTER 2.2

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By: Frank Z. Ruttenberg

1. **Introduction**. The process of determining the best entity for a client's purpose is often daunting. The legal advisor is challenged to determine the many needs of the client and make a recommendation which strikes the correct balance of each of these many needs. As a part of this process the client and legal advisor will generally consider the impact the form of entity will have on:

(i) the formation of the entity;

(ii) the initial and future capital needs of the business;

(iii) the method of sharing profits and losses among the owners of the business, including the personal exposure to risk of loss

(iv) the management structure of the business;

(v) taxation of the business, and

(vi) the exit plan or back door for the various owners of the business when circumstances dictate that they can no longer participate in the business.

It is the role of legal counsel to help the business owner recognize these issues, apprise them of the various options available and assist the client in assessing the best entity structure for the start up, operation and grown of their business.

In the process of making this assessment, it is also important for the legal advisor to understand that business may actually progress through several different stages of growth……the start up phase, the initial operating phase which may prove up the viability of the project, the growth stage and maturation phase. It is very likely that the business may, in fact, need the flexibility to morph or change entity forms as it moves through these very different stages in its life.

The primary purpose of this outline is to address several of the more material formation issues the legal advisor many encounter in connection with the formation of a business entity in the State of Texas, and consider some of the options available to the client to address these issues.

2. **Primary Formation Issues.** As a new business is conceived, the issues most often presented to the business owner are most often as follows, in no particular area of relative importance?

(a) Sharing of profits and losses,

(b) limitations on liability,

(c) the taxation of profits and losses generated from the entity (state and local issues),

(d) management and decision making process, or governance of the business,

(e) formation of capital,

(f) Ease of transferability of interest,

(g) Exist strategy for an owner;

(h) Exit strategy for the entity,

(i) cost of formation and operation.

3. **Business Entities**. In Texas, the primary forms of entities available to address these issues are as follows:

(i) Corporation

(ii) General Partnership (GP)

(iii) Limited Liability Partnership (LLP)

(iv) Limited Partnership (LP)

(v) Limited Liability Company ("LLC")

4. **Governing Laws - Texas**.

(a) State Laws Relating to Formation. The TBOC re-codified the existing Texas statutes governing business entities. Generally, entities organized under Texas law prior to January 1, 2006 will be subject to the specific act relating to that business entity (TBCA, TRLPA, TRPA, TLLCA.

For entities formed on or after January 1, 2006, the entity will operate pursuant to the Texas Business Organizations Code ("TBOC"). In addition, generally speaking the entities formed prior to January 1, 2006, will continue to operate under their applicable pre – 2006 Act until (i) they opt into the TBOC or (ii) January 1, 2010.

The TBOC adopts a "hub and spoke" approach to the reorganization of the business entities laws in the State of Texas. The provisions of TOBC attempted to collect those provisions common to all entities in a central "hub" of the TBOC found in Title 1. Separate

"spokes" contain provisions governing different types of entities which are not common or similar among the different entities.

(b) State Laws Relating to Taxation.

On May 15, 2006, the Texas Legislature passed House Bill 3 to replace the current franchise tax on corporations and LLCs with a new and novel business entity tax called the "Margin Tax". The Margin Tax is imposed on all businesses except (i) sole proprietorships, (ii) general partnerships, the direct ownership of which is entirely composed of natural persons, and (iii) certain "passive" entities. Thus, corporations, limited partnerships, certain general partnerships, LLPs, LLCs, business trusts and professional associations are now subject to the Margin Tax. The Margin Tax is not imposed on sole proprietorships, general partnerships that are owned 100% by natural persons, certain narrowly defined passive income entities, grantor trusts, estates of natural persons.

Passive entities must have at least 90% of their gross income for federal income tax purposes from partnership allocations from other flow through entities, dividends, interest, royalties, or capital gains from the sale of real estate, securities, or commodities.

Taxable entities that have $300,000 (with CPI adjustments for later years) or less in gross revenue in a year, or whose Margin Tax liability is less than $1,000 are also exempt for that year. Taxable entities that have less than $900,000 in gross revenue in a year become subject to a phased in tax rate schedule.

(c) Federal Income Tax Laws.

(i) Generally, (i) a corporation is considered a separate person for Federal Income Tax purposes, and subject to a corporate level tax on its income and losses, and (ii) partnerships (and LLC's, see Treas. Reg. § 301.7701-3(b)(1)) are not considered a separate person for such purposes, and therefore pass through to its owners the tax attributes of its income or loss.

(ii) The default rules under Treas. Reg. § 301.7701-3(b)(1) provide that a domestic eligible entity that is not a corporation ***is a partnership*** if it has two or more members and is disregarded as a separate entity if it has a single owner.

(iii) An eligible entity that desires to obtain a classification other than under the default classification rules, or desires to change its classification, may file an election with the IRS on Form 8832 (the "Check the Box" election).

(iv) In addition to the Check the Box rules set out above, in certain cases a corporation may qualify to make an S election with the Internal Revenue Service. The result of electing S-corporation status is that no corporate level tax is imposed on the corporation's income. Instead, corporate level income is treated as having been received

by the shareholders (note, like a partnership, this is whether or not such income was actually distributed, and is taxed at the shareholder level). This tax status allows losses to be passed through to the shareholders in a manner similar to a partnership; however, unlike a partnership, a shareholder's deduction for S-corporation losses is limited to the sum of the amount of the shareholder's adjusted basis in his stock and in the corporation's indebtedness to the shareholder.

(d) Self Employment Tax. Individuals are subject to a self-employment tax on self-employment income. Self-employment income generally means an individual's net earnings from the individual's trade or business. An individual's self-employment income includes his distributive share of the trade or business income from a partnership of which he is a partner (including an LLC classified as a partnership for federal income tax purposes), *subject to* the exception that a limited partner's distributive share of income or loss from a limited partnership generally will not be included in his net income from self employment. In certain cases the members of an LLC may be treated as a limited partner (not subject to self employment tax) under proposed regulations. This will likely be tied to the level and nature of the activity of the member in the business of the entity. Until the proposed regulations are effective for an LLC Member, there is a risk that the IRS will treat any individual Member's distributive share of the trade or business income of the LLC as being subject to self-employment tax.

5. **Entity Form Analysis** –

(a) Corporation.

(i) limitations on liability – afford limited liability to all owners, subject to laws relating to piercing of a corporate veil.

In exceptional situations, a court will "pierce the corporate veil" to find a shareholder personally liable for the activities of the corporation. In TBOC Section 21.223, no shareholder, or affiliate of the shareholder or the corporation, may be held liable for (i) any contractual obligation of the corporation on the basis that the shareholder or affiliate is or was the alter ego of the corporation or on the basis of actual or constructive fraud, a sham to perpetuate a fraud or a similar theory, unless it is shown that the shareholder used the corporation for the purpose of perpetrating, and did perpetrate, an actual fraud, primarily for the personal benefit of the shareholder or affiliate or (ii) any obligation (whether contractual, tort or other) on the basis that the corporation failed to observe any corporate formality (e.g., maintaining separate offices and employees, keeping separate books, holding regular meetings of shareholders and board of directors, keeping written minutes of such meetings, etc.).

(ii) the taxation of profits and losses generated from a corporation is subject to Federal income tax. This has the effect of causing the earnings of the company to be subject to double taxation to the extent they are distributed to the owners of the company. The earnings are also subject to state Margin tax, as set out above.

(iii) The allocation of the profits and losses and distributions will be pro rata to the share ownership in the corporation, and cannot be varied.

(iv) management governance – centralized in directors and officers – management structure is well defined within the applicable statues.

(v) formation of capital – based upon the issuance of shares – lacks flexibility – however may be partially addressed by the issuance of different classes of shares there is a silo effect of profits being allocated within the silo of a tranche of shares issued. Within that silo shares will be treated the same as to contributions, distributions and voting rights related to those shares.

(vi) Ease of transferability of interest. – transferring shares in a corporation is very easy, subject to state and federal rules relating to securities laws and any limitations created by contract between the company and the shareholder.

Shareholders of a closely-held corporation often desire to prohibit the transfer of shares to persons who are not family members or are not employees of the corporation. To be enforceable, these restrictions on transfer must be reasonable under state law. In any event, an absolute restriction on transfer would be unreasonable and therefore void. The Tex. Corp. Stats. provide that, among other restrictions, rights of first refusal and limitations on transfer necessary to maintain S-corporation status or other tax advantages are reasonable restrictions on transfer. They also specify certain procedures that must be followed to assure the enforceability of the share transfer restrictions, such as the placement of a restrictive legend on stock certificates and the maintenance of a copy of the document containing the transfer restrictions at the corporation's principal place of business or registered office. Since shares in a closely-held business typically lack an established trading market, those shares may be nontransferable as a practical matter. If the owners of the business enterprise desire to conduct an initial public offering for its shares, the corporate form of entity is the best option except in certain limited circumstances.

In addition, shares in a corporation are generally considered "securities" within the meaning of state and federal securities laws. Transfers of shares may be required to be registered under such laws absent an applicable exemption from registration.

(vii) cost of formation and operation – documentation is very standardized allowing for a low cost of formation and operation.

Additional Considerations for Corporations. The by product of centralization of management is that those managing (the Directors) will owe fiduciary duties of care, loyalty and obedience to the corporation. The duty of care requires directors to exercise the degree of care that an ordinarily prudent person would exercise under similar circumstances. Generally, the duty of loyalty prohibits a director from usurping business opportunities that otherwise might be

pursued by the corporation; however, Texas law permits a corporation to waive any interest in business opportunities presented to the corporation or one or more of its officers, directors or shareholders in its certificate of formation or by action of its board of directors. The business judgment rule provides a degree of protection to decisions made by corporate directors. Under the business judgment rule, directors are presumed to have satisfied their fiduciary duties in making a business decision.

Methods for structuring indemnities of by the Corporation. Under the Tex. LLC Stats., an LLC may indemnify any of its Members, Managers, officers or other persons subject only to such standards and restrictions, if any, as may be set forth in the LLC's certificate of formation or Company Agreement. The restrictions on indemnification applicable to regular corporations are not applicable to LLCs.

(b) S-Corporation - The considerations for the use of an S-corporations are generally the same as a C corporations, with the following exceptions:

(i) The corporation is considered to be a pass through entity, much like a partnership for Federal Income Tax, with some notable exceptions such as the basis calculation for the ability to pass through losses.

(ii) The allocation of the profits and losses and distributions will be pro rata to the share ownership in the corporation, and cannot be varied.

(iii) The ownership of shares are limited to non foreign individuals, certain trusts and restricted to no more than 100 shareholders. In addition S corporations cannot be owned by C corporations, other S corporations, LLCs, partnerships, or many trusts.

(iv) S corporations can have only one class of stock (disregarding voting rights). C corporations can have multiple classes of stock

(c) Partnerships (joint ventures).

(i) limitations on liability – the major drawback to this form of entity is the fact that, each of the partners are jointly and severally liable for the obligations of the partnership.

(ii) The partnership is a pass through entity, the there is no entity level tax on the profits and losses generated from the entity – however in situation where it is not owned by individuals, it will be subject to the state margin tax.

(iii) The allocation of the profits and losses and distributions may be varied based on the terms of the partnership agreement; subject only to the requirements under Federal Income Tax laws that the allocations and impact of distributions meet the requirements for "substantial economic effect". No silo here – lots of flexibility.

(iv) management and governance – decentralized, in all of the partners subject to any limitations set out in the partnership agreement. The laws relating to partnership allow a great deal of flexibility as to how the partners desire to manage and operate their company. The laws relating to the operations of partnerships allow virtually any management structure to be set out in the partnership agreement, with certain limitations relating to the right to review records of the partnership and a base standard of care, duty and loyalty each of the partners will owe to each other. This is also the only one of the business entities that is not a filing entity under state law, and on that basis, allows for a certain degree of anonymity.

(v) formation of capital – due to the flexible nature of these entities (in particular the allocations and distributions of profits and losses) the partners have the ability to be very creative in connection with the formation of capital. As a by product, the partners may make disproportionate contributions to capital, and receive disproportionate allocations of profits and losses in connection the formation of the company.

(vi) transferability of interest. – limited transferability of interests due to special "agency like" relationship of the partners. Without agreement this relationship cannot be changed.

(vii) cost of formation and operation –. A general partnership can be one of the simplest, least expensive business entities to form because the existence of a partnership does only to depend on the intention of the parties and does not require a written partnership agreement to exist. Most of the time, however, partners will wish to have their relationship governed by a partnership agreement rather than rely on the default statutory provisions, and partnership agreements can be very complex.

Additional Considerations for partnerships – partners owe a high duty to each other, which has been referred to as fiduciary in nature. There is a defined duty of care, loyalty and good faith, although the degree of this duty can be varied by contract provided the limitations are not manifestly unreasonably. Loyalty requires a general partner to place the interests of the partnership ahead of his own interests. The duty of care requires a partner to act as a ordinarily prudent person would act under similar circumstances.

Under the Securities Act of 1933, the Securities Exchange Act of 1934, and most state blue sky laws, the term "security" is defined to include an "investment contract." The question of whether a general partnership interest is a security requires a case-by-case analysis. Where the investor can show that they have little power; the partner is inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers; or the partner is so dependent on the entrepreneurial or managerial ability of the promoter or manager, it is possible that they can take the position they are entitled to the protections afforded by the state and federal securities laws.

Indemnity– a general partnership is not subject to the "hub" TBOC Indemnity provisions.

(d) Limited Liability Partnership. A Limited Liability partnership is typically a general partnership (although you can have a n Limited Liability Limited Partnership) in which the individual liability of partners for partnership obligations is limited under certain circumstances. This species of general partnership represents an innovation in partnership law and was first authorized in 1991 by provisions added to the TUPA by Sections 83-85 of House Bill 278. This form of entity has spread throughout the US but, unlike other entity statutes, is not substantially uniform as to structure or application. Since the LLP is a partnership, it has all of the same attributes of a general partnership, as set out above, with the following primary exceptions:

(i) limited liability. while partners in a general partnership that is not an LLP are individually liable, jointly and severally, for all partnership obligations, including partnership liabilities arising from the misconduct of other partners, the LLP shield relieves a partner from individual liability for partnership obligations which arise from all contract obligations and, subject to certain insurance requirements described below, all other obligations which are in the nature of an error, omission, negligence, incompetence, or malfeasance committed by another partner or representative of the partnership while the partnership is a limited liability partnership and in the course of the partnership business unless the partner: (1) was supervising or directing the other partner or representative when the error, omission, negligence, incompetence, or malfeasance was committed by the other partner or representative; (2) was directly involved in the specific activity in which the error, omission, negligence, incompetence, or malfeasance was committed by the other partner or representative; or (3) had notice or knowledge of the error, omission, negligence, incompetence, or malfeasance by the other partner or representative at the time of the occurrence and then failed to take reasonable action to prevent or cure the error, omission, negligence incompetence, or malfeasance. The liability shield of the LLP is an affirmative defense, with the burden of proof on the partner claiming its benefit.

(ii) Requirements for LLP status.

1. an LLP must include in its name the words "limited liability partnership" or an abbreviation thereof.

2. a partnership must file with the Secretary of State of Texas an application accompanied by a fee for each partner of $200. Registration remains effective for a year.

3. the partnership must carry at least $100,000 of liability insurance of a kind that is designed to cover the kind of error, omission, negligence, incompetence, or malfeasance for which liability is limited by Section 152.801(b); or provide $100,000 specifically designated and segregated for the satisfaction of judgments

against the partnership for the kind of error, omission, negligence, incompetence, or malfeasance for which liability is limited by Section 152.801(b) by deposit of cash, bank certificates of deposit, or United States Treasury obligations in trust or bank escrow, a bank letter of credit.

(iii) The LLP is now subject to the margin tax.

(e) Limited Partnership. A "limited partnership" is a partnership formed by two or more persons, with one or more general partners and one or more limited partners. Since the LP is a partnership, it has all of the same attributes of a partnership, as set out above, with the following primary exceptions:

(i) Limitation on liability

1. A general partner of a limited partnership has the same unlimited liability as does a partner of a general partnership (see LLLP provisions for some additional protection).

2. A limited partner's liability for debts of or claims against the partnership is limited to the limited partner's capital contribution to the partnership (plus any additional amounts agreed to be contributed). The equitable rules relating to the piercing of entity veil have not been applied here since there is always a person (the general partner) who is legally liable.

(ii) management and governance – centralized in the general partner and there are somewhat strict limits on the extent and manner in which a limited partner may be involved in the management of the company without jeopardizing their limited liability status.

(iii) cost of formation and operation – A limited partnership does not require a written partnership agreement to exist. Most of the time, however, partners will wish to have their relationship governed by a partnership agreement rather than rely on the default statutory provisions, and partnership agreements can be very complex.

(iv) Partners owe a high duty to each other, which has been referred to as fiduciary in nature. The general partner has a much greater control over the operations of the company than the limited partners. For this reason the general partner may have a much greater duty to the limited partners than the limited partner may have to the general partner.

(v) Under the Securities Act of 1933, the Securities Exchange Act of 1934, and most state blue sky laws, the term "security" is defined to include an "investment contract." Since limited partners, by there nature will likely have little power over the operations of their investment; it is likely the limited partners will have the ability to take

the position they are entitled to the protections afforded by the state and federal securities laws.

Indemnity an LLC may indemnify any of its Members, Managers, officers or other persons subject only to such standards and restrictions, if any, as may be set forth in the LLC's certificate of formation or Company Agreement. The restrictions on indemnification applicable to regular corporations are not applicable to LLCs.

(vi) Limited Liability Company - The Limited Liability Company was designed to combine the unique attributes of limited liability and centralized management, found in the corporate structure with the true pass through nature of a partnership, without the baggage and limitations of an S-Corporation. Under the IRS Check-the-Box Regulations, a domestic LLC with two or more Members will be treated for federal income tax purposes as a partnership. The LLC is based, in large part upon a contract between its Members, similar to a partnership agreement. As a result, fundamental principles of freedom of contract imply that the owners of an LLC have maximum freedom to determine the internal structure and operation of the LLC. The Tex. LLC statutes also permit formation of a one-Member LLC which will be disregarded as an entity separate from its owner for federal Income tax purposes (unless it elects to be taxed as a corporation under the check the box rules). Most of the provisions relating to the organization and management of an LLC and the terms governing its securities are to be contained in the LLC's company agreement which will typically contain provisions similar to those in limited partnership agreements and corporate bylaws in some appropriate manner. Due to the flexibility of these entities, the owners may structure the management in a somewhat ridged format (like a corporation, with directors and officers) or in a decentralized manner like a general partnership with the members managing the operations.

(vii) The owners of an LLC are called "Members," and are analogous to shareholders in a corporation or limited partners of a limited partnership. The "Managers" of an LLC are generally analogous to directors of a corporation and are elected by

(viii) limitations on liability – likely to be treated as a corporation, with limited liability for its owners but subject to the laws which relate to the ability to pierce a corporate veil.

(ix) the taxation of profits and losses generated from the entity (state and local issues). – treated like partnerships with true pass through treatment.

(x) management and decision making process, or governance of the business – flexibility to use corporate structure or partnership structure.

(xi) formation of capital – the maximum flexibility of partnerships

(xii) Ease of transferability of interest. – Since these entities are creatures of statue there are not the old agency principals that apply making transferability of interest difficult. Unless otherwise provided in an LLC's Company Agreement, a Member's interest in an LLC is assignable in whole or in part.

(xiii) cost of formation and operation – similar to a partnership, due to the flexibility of the entity, there may be greater cost in drafting the Operating Agreement but there is no requirement for annual meetings like corporations.

(xiv) Fiduciary Duties. The Tex. LLC statues do not attempt to define if Managers or Member have fiduciary duties to the other Members or the Company. By analogy, it is likely these organizations with take on the same responsibilities as Corporations, with the application of the business judgment rule for Managers or managing Members. Much like a corporate director who, in theory, represents all of the shareholders of the corporation rather than those who are responsible for his being a director, a Manager should be deemed to have a fiduciary duty to all of the Members. Whether Members owe a fiduciary duty to the other Members or the LLC will likely be determined by reference to corporate principles in the absence of controlling provisions in the certificate of formation or Company Agreement.

(xv) Indemnities by the LLC. Under the Tex. LLC Stats., an LLC may indemnify any of its Members, Managers, officers or other persons subject only to such standards and restrictions, if any, as may be set forth in the LLC's certificate of formation or Company Agreement. The restrictions on indemnification applicable to regular corporations are not applicable to LLCs.

(xvi) Margin Tax. An LLC is subject to Texas Margin Tax.

6. Review of a Representative Company Agreement form:

COMPANY AGREEMENT
FOR XYZ LIMITED LIABILITY COMPANY
]

THE OWNERSHIP INTERESTS THAT ARE THE SUBJECT OF THIS COMPANY AGREEMENT HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR ANY STATE SECURITIES LAWS. THE INTERESTS MAY NOT BE OFFERED FOR SALE, SOLD, PLEDGED, TRANSFERRED, OR OTHERWISE DISPOSED OF UNTIL THE HOLDER THEREOF PROVIDES EVIDENCE SATISFACTORY TO THE MANAGERS (WHICH, IN THE DISCRETION OF THE MANAGERS, MAY INCLUDE AN OPINION OF COUNSEL SATISFACTORY TO THE MANAGERS) THAT SUCH OFFER, SALE, PLEDGE, TRANSFER, OR OTHER DISPOSITION WILL NOT VIOLATE APPLICABLE FEDERAL OR STATE SECURITIES LAWS.

THE OWNERSHIP INTERESTS THAT ARE THE SUBJECT OF THIS COMPANY AGREEMENT ARE SUBJECT TO RESTRICTIONS ON THE TRANSFER, SALE, PLEDGE, OR OTHER DISPOSITION AS SET FORTH IN THIS COMPANY AGREEMENT.

Practice Comment: This legend is sometimes used to help a Limited Liability Company comply with the requirements of Regulation D under the Securities Act of 1933. If the ownership interests are to be certificated as authorized by §3.201(e) of the Texas Business Organizations Code ("*TBOC*"), legends similar to those appearing on this page should appear on the certificates.

Practice Comment: Confirm that this legend is consistent with any restrictions on transfer contained in the Company Agreement.

COMPANY AGREEMENT
OF
XYZ LIMITED LIABILITY COMPANY

This Company Agreement of XYZ Limited Liability Company is executed as of the Effective Date, by each of the persons who signs this Agreement under the caption "Members" on the signature page of this Agreement.

Note Change : The new term for this arrangement is a "Company Agreement". According to the Revisor Note, this was done, in part, to reflect the contractual nature of this arrangement.

ARTICLE 1
DEFINITIONS

1.1 ***Certain Definitions***. As used in this Agreement, each of the following terms has the meaning given to it below:

"Affiliate" shall mean (i) any person directly or indirectly controlling, controlled by or under common control with another person; (ii) any person that, directly or indirectly, owns or controls 10% or more of the outstanding voting securities or beneficial interests of such other person; (iii) any officer, director, trustee member, manager or general partner of such person; (iv) if such other person is an officer, director, member or manager, trustee or partner of another

entity, then the entity for which that person acts in any such capacity; (v) any spouse or issue of the person or any person who is of a relationship described in Section 267 (b) of the IRS Code substituting 10% in place of 50%, where applicable, and (vi) an entity formed which is to be owned directly or indirectly for the benefit of any of the persons described in subparagraph (v) above. For purposes of this paragraph and for determining when a person is directly or indirectly controlling, controlled by or under, controlled with any other person, the term control shall refer to an interest of 10% or more of the outstanding voting securities or beneficial interest of such person.

Practice Comment: This definition needs to be reviewed to determine if it is appropriate for the particular transaction and provision. It may have application in both a restrictive sense (*e.g.*, a restriction on dealings with affiliates) or a permissive sense (*e.g.*, transfers of Company interests are permitted to be made without consent if they are made to affiliates). In each case the drafter will need to be certain the definition provides the desired results.

"*Agreement*" means this Company Agreement, as amended from time to time.

"Assignee" means a Person who receives a Transfer of all or a portion of the Membership Interest of a Member, but who has not been admitted to the Company as a Member in connection with such Transfer.

"*Base Rate*" means a rate per annum that from day to day is equal to the lesser of (a) the prime rate of interest as cited by *The Wall Street Journal* and (b) the maximum rate permitted by applicable laws, with each change in the rate to be made on the same date as any change in (a) or (b), as appropriate.

"*Business Day*" means any day other than a Saturday, a Sunday, or a holiday on which national banks in the State of Texas are permitted to be closed.

"*Capital Account*" means, with respect to any Member, the capital account maintained for a Member in accordance with the rules of Section 1.704-1(b)(2)(iv) of the Regulations.

Practice Comment: The TBOC does not provide a definition of Capital Account for LLCs– this definition is provided to comport with the requirements of the IRS Code. Capital Accounts may also be the basis on which distributions are made if the Company Agreement and Company books and records are silent as to distributions. TBOC §101.203

"*Capital Contribution*" means, with respect to any Member, the amount of money and the initial Gross Asset Value of property (other than money) contributed to the Company by such Member (or its predecessors in interest) with respect to their Membership Interest in the Company reduced by any indebtedness either assumed by the Company in connection with such contribution or to which such property is subject when contributed.

"*Certificate*" means, at any time, the certificate of formation of the Company filed with the Secretary of State of the State of Texas pursuant to the TBOC, as amended or restated at such time.

"*Claims*" means all losses, costs, liabilities, damages, and expenses (including court costs and fees and disbursements of counsel) incurred in connection with a Proceeding.

"*Company*" means the limited liability company formed pursuant to this Agreement.

"*Distributable Cash*" means all cash funds of the Company on hand at any time after payment of all expenses of the Company due as of such time, as reduced by the amount of the Working Capital Reserve and Liquidation Reserve, if any, at such time.

"*Effective Date*" means the later of (i) date all of the parties required to sign this Agreement have signed and delivered the Agreement, or (ii) the date the Company is formed, as set out herein.

"*Fair Value*" means, the fair value of the item being valued, as determined by an appraiser selected in accordance with the terms of this Agreement.

"*Fiscal Year*" means the fiscal year of the Company's operations as selected by the Managers of the Company for accounting purposes.

"*Gross Asset Value*" means, the value of any asset contributed to the Company as determined by the contributing Member and the Managers, and if no such agreement is reached, the asset's adjusted basis for Federal income tax purposes.

"*Gross Income*" means, an amount equal to the Company's gross income as determined for Federal income tax purposes but computed with the adjustments in paragraphs (a) and (b) of the definition of "Profits" and "Losses."

"*IRS Code*" means, at any time, the Internal Revenue Code of 1986, as amended, or, from and after the date any successor statute becomes, by its terms, applicable to the Company, such successor statute, in each case as amended at such time by amendments that are, at that time, applicable to the Company. All references to sections of the IRS Code include any corresponding provision or provisions of any such successor statute.

"*Liquidation Reserve*" means that reserve of Company funds held by the Company in connection with its process of winding up for the purpose of addressing obligations of the Company which may become due during the winding up process or after the termination of the Company.

"*Majority*" means, with respect to any group entitled to vote on a matter, more than Fifty Percent (50%) of the votes of that group.

"*Management Fee*" means, with respect to any calendar year, an amount equal to $_____. If a payment is due with respect to only a portion of a calendar year, such amount will be prorated using the actual number of days in such portion over a 365- or 366-day year, as appropriate.

Practice Comment: If the Managers are to receive compensation, the Agreement should expressly provide for it.

"*Manager***"** means any Person named in the Articles as an initial manager of the Company and any Person hereafter elected as a manager of the Company as provided in this Agreement, but does not include any Person who has ceased to be a manager of the Company.

"*Member*" means each of the persons who execute this Agreement as a Member and becomes a Member under the terms of this Agreement as well as each person who is otherwise admitted to the Company as a Member under the terms of this Agreement.

Practice Comment: This Agreement is structured with one class of Members. To accommodate special aspects of a business arrangement there may also be multiple classes of Members. In these cases the Agreement will need to be drafted to identify these classes and define their relative rights and obligations under the terms of the Agreement. §Section 3.002 of the TBOC.

"*Membership Interest*" means, at any time, the interest of a Member in the Company, including the right to receive distributions of Company assets and the right to receive allocations of income, gain, loss, deduction, or credit of the Company, but does not include the voting rights or management rights reserved to the Members under the terms of this Agreement (or the right to vote the Units relating thereto) until such holder of the Membership Interest has been admitted to the Company as a Member as to that Membership Interest.

Practice Comment: This tracks the definition of "membership interest" found in §1.001(54) of the TBOC. This definition reinforces the fact that a Membership Interest includes only the economic rights -- not management and other non-economic rights. Management and other non-economic rights are conferred by virtue of Member status and not by mere ownership of a Membership Interest. The last phrase is intended to incorporate those management rights into the terminology once the requirements for admission as a Member has been completed – this is intended to avoid any gap in what is transferred when a practitioner, using common terminology, addresses the sale and acquisition of all of the “Membership Interest".

"*Notice*" means any notice delivered in the manner set out in the "Miscellaneous" Section of this Agreement.

"*Permitted Transferee*" means (i) any person directly or indirectly controlling, controlled by or under common control with the Member; and (ii) any trust for the Member, the Member's spouse or children or any other person who is of a relationship described in Section 267(b) of the IRS Code substituting 80% in place of 50%, where applicable, provided the Member is the sole acting trustee of the trust (with the understanding that when the Member is no longer the sole acting trustee this may be an unauthorized transfer thereafter). For purposes of this paragraph and for determining when a Person is directly or indirectly controlling, controlled by, or under control with any other Person, the term control shall refer to an interest of 80% or more of the outstanding voting interests or beneficial interest of such Person.

Practice Comment: This definition is intended to provide a definition for those persons who will be permitted transferees under the terms of the Agreement, therefore not subject to the vote of the Members. This is a broad definition of related parties. Often the parties will want to keep this to a small group.

"*Person*" means any business entity, trust, estate, executor, administrator, or individual.

"*Preferred Return*" means, with respect to any Member, an amount calculated as a cumulative, non-compounded [compounded] per annum rate equal to the Return Rate on the average daily balance of the unreturned Capital Contributions of such Member.

Practice Comment: On occasion, certain Members (sometimes referred to as carried Members) will contribute only a minimal portion of the aggregate capital contributions while others contribute a larger proportionate share. In such a situation, a provision requiring a preferred return to those who have contributed a larger proportionate share may be incorporated into the Agreement.

"*Proceeding*" means any threatened, pending, or completed action, suit, or proceeding, whether civil, criminal, administrative, arbitrative, or investigative, any appeal in such an action, suit, or proceeding, and any inquiry or investigation that could lead to such an action, suit, or proceeding.

"*Profits* and "*Losses*" means, the Company's taxable income or taxable loss as determined under the IRS Code but with the following adjustments:

Any income of the Company that is exempt from Federal income tax and not otherwise taken into account in computing Profits and Losses pursuant to this definition of "Profits" and "Losses" will be added to such taxable income or loss;

Any expenditures of the Company described in IRS Code Section 705(a)(2)(B) or treated as IRS Code Section 705(a)(2)(B) expenditures pursuant to Section 1.704-1(b)(2)(iv)(i) of the Regulations that are not otherwise taken into account in computing Profits and Losses will be subtracted from such taxable income or loss.

Practice Comment: This is a somewhat simplified version of a definition of Income and Loss. There are several additional adjustments which your tax advisor may recommend to the language to make it most accurate for your particular transaction.

"*Return Rate*" means _____% per annum.

Practice Comment: As noted above, if certain Members contribute disproportionately greater capital they may require a rate of return on their excess capital until returned.

"*Section*" means a section of this Agreement, unless the text indicates otherwise.

"*Sharing Ratio*" means the ratio in which the Members share Profits and Losses, from time to time, as set out under the terms of this Agreement.

Practice Comment: This Agreement provides for fixed sharing ratios throughout the term of the Agreement. Where Profits and Losses will be shared on a disproportionate basis at times during the term of the Agreement, this definition may need to be adjusted in the text of the Agreement to address the shifting of these rights.

"*Super Majority*" means, with respect to the Members or any group of Members entitled to vote on a matter, one or more members of that group who hold more than sixty six and 2/3rds of the votes held by that group.

"*TBOC*" means, at any time, the Business Organizations Code of the State of Texas, as amended, or, from and after the date any successor statute becomes, by its terms, applicable to the Company, such successor statute, in each case as amended at such time by amendments that are, at that time, applicable to the Company. All references to sections of the Business Organizations Code include any corresponding provision or provisions of any such successor statute.

"*Transfer*" means (a) any sale, transfer, encumbrance, gift, donation, assignment, pledge, hypothecation, or other transfer of any Membership Interest or any interest therein, whether voluntary or involuntary, and whether during the transferor's lifetime or upon or after the transferor's death, including any transfer by operation of law, by court order, by judicial process, or by foreclosure, levy, or attachment; or (b) the act of making any of the foregoing.

Practice Comment: Consider whether to include a change in control to capture indirect transfers of a Company interest through a change in control of an entity that owns the Company interest.

"*Treasury Regulations*" or "*Regulations*" means, at any time, the Federal income tax regulations promulgated under the IRS Code that are in effect at such time and that, by their terms, are applicable to the Company at such time. All references to sections of the Regulations include any corresponding provision or provisions of any such successor regulations.

"*Unit*" means an increment of interest in the Company assigned to each Member in connection with a Membership Interest that represents an original Capital Contribution of $_____ and which, in each case where the Members, or a group of Members are entitled to vote or make a decision under the terms of this Agreement, will carry one vote

"*Working Capital Reserve*" means those reserves which the Managers determine to be necessary [or useful] in their [reasonable] discretion for future cost, expenses, capital investment, or contingencies which may be incurred by the Company.

1.2 ***Other Definitions; References to Definitions***. Other terms defined herein have the meanings so given them. Each reference in this Agreement to a definition is a reference to a definition contained in this Agreement, unless the context expressly provides otherwise.

ARTICLE 2
ORGANIZATIONAL MATTERS

2.1 ***Formation***. The Members hereby form the Company pursuant to the TBOC, as of the Effective Date.

Practice Comment: Formed when the filing is effective §3.001(c). Members can have oral agreements for LLC

§101.001 but certain provisions, like a promise to make contributions, must be in writing and signed to be enforceable. §101.151 TBOC

2.2 ***Name***. The name of the Company is "XYZ LLC." The business of the Company will at all times be conducted under such name and such other name or names as the Managers may select, from time to time.

Practice Comment: The name of the Company must satisfy the requirements of §5.056 of TBOC.

2.3 ***Name and Address of Initial Members***. The name and address of each Member is set forth on Exhibit A. Each such person shown on Exhibit A on the effective date of this Agreement is admitted to the Company as a Member upon its formation. Any change in the name or address of a Member of which the Company is given notice will be as set forth in the records of the Company and Exhibit A will be deemed amended appropriately. The Managers may substitute a new Exhibit A (indicating its effective date) to reflect such additional and/or different information. The records of the Company will be *prima facie* evidence of the status of any person as a Member.

2.4 ***Registered Office and Registered Agent***. The address of the registered office of the Company in the State of Texas will be at _____ and the name of the registered agent of the Company at such address will be_____. The Managers may at any time, and from time to time, designate a new or successor registered office or registered agent, or both.

2.5 ***Principal Office and Other Offices***. The principal address and place of business of the Company will be _____ or such other place that is consistent with the purpose of the Company as the Managers may designate from time to time by notice to the Members. The Company may have such other office or offices as the Managers may designate from time to time by notice to the Members.

2.6 ***Purpose***. The purpose of the Company is to _____ and undertake all matters that may be incidental thereto.

Practice Comment: Be careful when defining the purpose of the Company. Avoid using the phrase "and such other purposes for which a limited liability Company may be formed under the TBOC" or similar open-ended language unless the Members intend to engage in all of their business endeavors through this Company. The purpose clause is often used to interpret the scope of authority for the Managers.

Practice Comment: Consider whether the Company should be permitted to operate its business through a subsidiary in order to give the Company more flexibility in meeting the requirements of certain lenders who may want the assets in a bankruptcy-remote entity. If this is done, consider the management issues that will need to be incorporated into the formation documents for the subsidiary to preserve any decision making rights of the Managers or Members in its operations.

2.7 ***Certificate; Foreign Qualification***. A certificate of formation that meets the requirements of the TBOC will be filed with the Secretary of State of the State of Texas and will be amended from time to time as required by the TBOC. Upon the request of the Managers,

each Member will immediately execute all certificates and other documents consistent with the terms of this Agreement that the Managers believe are necessary or desirable for the Managers to accomplish all filing, recording, publishing, and other acts as may be appropriate to comply with all requirements to form, operate, qualify, and continue the Company as a (a) limited liability company under the TBOC and the laws of the State of Texas and (b) limited liability company, or a company in which each Member has limited liability in all other jurisdictions where the Company proposes to operate.

2.8 ***Term***. The Company's existence will commence on the effective date of the initial filing of the Certificate with the Secretary of State of the State of Texas and will continue until the Company terminates pursuant to the terms of this Agreement. The Company may not conduct business until the Certificate has been filed with the Secretary of State of the State of Texas.

Practice Comment: Filing entities are now perpetual unless the governing documents state otherwise. §3.003 TBOC. The perpetual duration no longer needs to be recited in the Certificate. You may want to include a statement relating to the perpetual duration to remind the clients that there is no fixed term unless otherwise set out in the Agreement. If there is a fixed term this will need to be set out in the Certificate and in this Agreement.

Practice Comment: Please note there is a difference between the winding up of this entity and its termination.` The Company may begin to wind up under certain circumstances set out in the TBOC and the Company Agreement, however it will continue in existence in order to complete the liquidation and winding up of the Company's affairs. If the Company continues only until the occurrence of an event requiring a winding up, the event requiring a winding up and termination must, by definition, occur at the same time, which is not practical and creates a question as to status of the Company is during the winding-up phase.

2.9 ***Merger, Conversion, Interest Exchange***. The Company may effect or participate in a merger, conversion, or interest exchange (as such terms are defined in the TBOC) or enter into an agreement to do so with the consent of the Managers and of a Super Majority of the Members.

ARTICLE 3
MEMBERSHIP

3.1 ***Initial Members.*** The initial Members of the Company are the Persons executing this Agreement as Members as of the Effective Date of this Agreement, each of which is admitted to the Company as a Member effective contemporaneously with the execution by such Person of this Agreement and the formation of the Company.

3.2 ***Sharing Ratio.*** The Sharing Ratio for each of the Members is set out below:

Member	Sharing Ratio
_____	_____
_____	_____

_____	_____
_____	_____
Total	100%

Practice Comment: Sharing Ratios define the manner in which Profits and Losses as well as distributions will be shared among the Members and are, therefore the cornerstone to defining the business arrangement between the Members. This Section may be structured with constant Sharing Ratios, or those which change from time to time to accommodate special allocations of profits or losses among some or all of the Members. They may also change at the time of a payout of capital to certain Members, or the completion of a priority return to a select group of the Members. To accommodate the economics of the deal, these provisions may and can be fairly complex. To accomplish these distinctions, Members are sometimes denominated in classes (the "A" Members and "B" Members), where A Members have contributed less money to the Company and "B" Members proportionately more. Distinctions of this type are often useful for the purpose of establishing priority returns among classes (.i.e. the distributions will be first made to the Class "B" Members in proportion to their Sharing Ratios until they have received a return of their Capital Contribution plus their Preferred Return).

3.3 ***Limitations on Members' Rights.*** Except as otherwise specifically provided in these Regulations to the contrary, no Member shall have the right:

(i.) To participate in the control of the business affairs of the Company except as expressly provided herein; transact any business on behalf of or in the name of the Company; or have any power or authority to bind or obligate the Company; such powers being vested in the Managers.

(ii.) To have his/her capital contribution repaid except to the extent provided in this Agreement.

(iii.) To require partition of the Company's property or to compel any sale or appraisal of the Company's assets.

(iv.) To sell, transfer, or assign his/her interest in the Company, except as provided in this Agreement.

3.4 ***New Members***. The Managers may admit additional Members and issue additional Membership Interest with additional Units in the Company on the terms and conditions which are approved by a Super Majority of the Members. At the time any new Members are admitted to the Company the Sharing Ratios shall be adjusted to reflect the terms and conditions upon which the new Members have been admitted.

Practice Comment: This provision gives the Members authority to admit additional Members, from time to time, with the issuance of additional Units. Without an express provision in the Company agreement, a person who acquires an interest in the Company directly from the Company after the formation of the Company may become a Member in the Company only with the consent of all Members. *See* §101.105 of the TBOC. This should also be coordinated with the amendment provisions of the Agreement.

ARTICLE 4
CAPITAL CONTRIBUTIONS AND LOANS

4.1 ***Contribution***. Simultaneously with the execution of this Agreement, the Members will contribute to the Company that property set out opposite their respective name on Exhibit B attached hereto. In consideration for such contribution, the Company shall cause to be issued to each of the Members (i) the Membership Interest and (ii) the number of Units in the Company set out on Exhibit B attached hereto.

Practice Comment: While a company agreement can be oral, a promise to provide a capital contribution must be in writing and signed by the person making the promise. §101.151 TBOC
Practice Comment: `The TBOC provides a broad list of remedies for a failure to make the capital contribution which is similar to the Texas Limited Liability Company Act. These include the right of forfeiture, as well as any other consequence. 101.153(b) TBOC
Practice Comment: Consider the impact of consequential damages for a failure to contribute. Can you be liable for far greater than the aggregate of the anticipated contribution?
Practice Comment: The parties may want to include special remedies for a monetary default of this nature which differs from those for a general default.
Practice Comment: Additional capital contributions by Members may themselves involve the sale of securities so it is important to confirm compliance with all applicable securities laws at the time they are sought.
Note: The TBOC also makes clear that no contribution is required to be a Member. Section 101.103.

4.2 ***Additional Contribution.*** Each of the Members will contribute to the Company that property set out opposite their respective name on Exhibit C at the times set out therein. The contributions to be made by the Members set out on Exhibit C shall only be required on the terms and conditions set out on Exhibit ____ and no person may otherwise require the Members to make such Capital Contributions to the Company.

Practice Comment: See comments above.

4.3 ***No Additional Contributions***. No Member will be required to make any Capital Contributions to the Company beyond those described in this Agreement, otherwise agreed to in writing by the Members from whom such additional Capital Contribution is sought or as may be required by a non - waivable provisions of the TBOC..

4.4 ***Return of Contributions***. No Member is entitled to the return of any part of its Capital Contributions or to be paid interest in respect of either its Capital Account or its Capital Contributions. An unreturned Capital Contribution is not a liability of the Company or of any Member.

4.5 ***Loans by Members***. Any Member, with the Managers' consent, may loan funds to or on behalf of the Company. Unless otherwise agreed by the Company and the lending Member, a loan described in this Section is payable on demand, bears interest at the Base Rate from the date of the advance until the date of payment, and is not a Capital Contribution.

Practice Comment: The Members may want to specify other terms of any such loans, including payment schedule, security, subordination, etc. The Members may also prefer to specify that all Members have a right of first refusal to make a loan rather than deferring to the Managers' discretion on who may act as a lender.

4.6 ***Capital Accounts***. There will be established for each Member a Capital Account on the books of the Company to be maintained and adjusted pursuant to this Agreement, including adjustments for contributions, distributions, and allocations of Profits and Losses.

Practice Comment: Capital accounts are typically used to keep track of the economics of the Members for both tax and other purposes.

4.7 ***Other Provisions With Respect to Capital Contributions***. Except as otherwise provided in this Agreement, no Member will be entitled to priority over any other Member with respect to a return of its Capital Contributions.

ARTICLE 5
DISTRIBUTIONS AND ALLOCATIONS OF PROFITS AND LOSSES

Practice Comment: The process of allocating the profits and losses of a limited liability company are the most basic elements for the economics of the deal between the Members. It is in this Section and the sections dealing with the contributions to the Company and distributions from the Company that define the economic arrangement between these parties. In the most basic sense, provisions of the Company Agreement which address contributions and distributions define the direct economic benefits the Members are to receive and be obligated for, while the Capital Accounts operate as the accounting system which allocates among the Members the benefits and obligations actually generated from the operations of the Company. The key is to make these two systems match; that is; to have economic effect of the allocation of Profits and Losses to the Members match the actual right and obligations of the Members, as required by the IRS Code.

Practice Comment: Since these concepts began developing in the 1980's, practitioners have struggled to meet the requirement that these concepts match. At the moment, there are two (maybe three) philosophies which might be followed to achieve the intended results of the parties in defining this economic relationship. The first is to try to draft the two schemes to match. The second is to define the nature in which Distributions and Contributions are to be made and cause the capital account accounting process to "fit" the contribution/distribution scheme. A third structure, which is probably most prevalent, is to make the Contributions and Distributions match the parties expectations, and have a Profit and Loss allocation that generally addresses the basis arrangement but does not match, in every case, the method by which Distributions and Contributions are shared.

Practice Comment: The problem with the first philosophy is that it is difficult to achieve since there are so many different circumstances that can arise which affect Capital Accounts and Distributions schemes.

Practice Comment: The second philosophy seems the most practical, however when attorneys sat down to draft the language to make this concept happen (and it seems to work) it is a formula that is so complex it will challenge the patience of even some of the brightest transactional attorneys. In addition, Clients tend to get upset when they are presented language they cannot fully understand.

See example below of typical clause:

"Profits and Losses for each Adjustment Period will be allocated among the Interest Owners so as to reduce, proportionately, in the case of Profits, the excess of their respective Target Capital Accounts over their respective Partially Adjusted Capital Accounts for such Adjustment Period and, in the case of Losses, the excess of their respective Partially Adjusted Capital Accounts over their respective Target Capital Accounts for such Adjustment Period. No portion of Profits or Losses for any Adjustment Period will be allocated to an Interest Owner, in the case

of Profits, whose Partially Adjusted Capital Account is greater than or equal to its Target Capital Account or, in the case of Losses, whose Target Capital Account is greater than or equal to its Partially Adjusted Capital Account for such Adjustment Period.

"Target Capital Account" means, with respect to any Interest Owner as of the close of business on the last day of any Adjustment Period, an amount (which may be either a positive or a deficit balance) equal to the amount such Interest Owner would receive as a distribution if all assets of the Partnership as of such date were sold for cash equal to the Gross Asset Value of such assets, all the Partnership liabilities were satisfied to the extent required by their terms, and the net proceeds were distributed pursuant to Section 4.1.

"Partially Adjusted Capital Account" means, with respect to any Interest Owner as of the close of business on the last day of any Adjustment Period, the Capital Account of such Interest Owner as of the beginning of such Adjustment Period, after giving effect to all allocations of items of income, gain, loss, or deduction not included in Net Profit and Net Loss and all capital contributions and distributions during such period but before giving effect to any allocations of Net Profit or Net Loss for such period pursuant to Section 4.2, increased by (i) such Interest Owner's share of Partnership Minimum Gain, as determined pursuant to Regulations Section 1.704-(2)(d), as of the end of such Adjustment Period and (ii) such Interest Owner's share of Partner Nonrecourse Debt Minimum Gain, as determined pursuant to Regulations Section 1.704-(2)(i), as of the end of such Adjustment Period.

"Adjustment Period" means any period of time that begins on the effective date of the filing of the Certificate with the Secretary of State of the State of Texas (in the case of the first Adjustment Period) or the day following the end of the immediately preceding Adjustment Period (with respect to each subsequent Adjustment Period) and ends on the first to occur of: (a) the last day of a Fiscal Year, (b) the day immediately preceding the date of the "liquidation" of a Partner's interest in the Partnership (within the meaning of Section 1.704-1(b)(2)(ii)(g) of the Regulations), or (c) the date on which the Partnership is terminated pursuant to Section 12.1(d) following the occurrence of an event requiring a winding up."

Practice Comment: For the reasons set out above, more often than not, we end up reading agreements that have been drafted under alternative 3. My best advice here is to make certain these provisions of a Company Agreement are reviewed by someone with a sound knowledge of the current provisions of the IRS Code and Treasury Regulations relating to Partnership law.

Practice Comment: For the purpose of this form, the contributions, distributions and allocations of profits and losses are assumed to be equal, which avoids much of the complexity that might otherwise be encountered.

5.1 ***Distributions of Distributable Cash***. Except as set out in Section 5.2, Distributable Cash will be distributed to the Members at such times as the Managers determine, in their sole [reasonable] discretion. Distributions of cash or property in respect of a Company Interest will be made only to the Person who, according to the books and records of the Company, is the holder of a Membership Interest in the Company on the date of such distribution. The date for any distribution of Distributable Cash will be determined by the Managers, in their sole discretion. The Distributable Cash of the Company (if any) will be distributed to the record owners of the Membership Interest in accordance with their Sharing Ratios.

Practice Comment: Distributions may vary for each transaction. In certain cases, they may be as set out above, in others they may provide a priority return to certain Members before others participate, or shifting Sharing Ratios. Careful attention should be given to these provisions to confirm that they reflect your client's intent. In certain circumstances, it may be appropriate to even make a distinction as to the character of the cash flow relating to the distribution, such as an arrangement which distributes cash flow from operations made in accordance with Sharing Ratios prior to the return on and of all capital contributions, and during that time period, have other distributions (*e.g.*, distributions from capital transactions) made in accordance with other priorities.

Practice Comment: Members may want to consider requiring distributions on a regular basis.

Practice Comment: LLC's are pass through entities for Federal Income Tax purposes. If distributions are to be made on a basis which is disproportionate to the allocations of profits, there may be taxable income allocated to a Member without a corresponding distribution. The Members may want to consider a special "tax" distribution which addresses this concern.

Practice Comment: Distributions have been structured based upon Sharing Ratios not Units. Separating Sharing Ratios from Units will allow for voting to remain the same (on a per Unit basis) while the allocation of Profits and Losses and the methods of distributions are based upon the Sharing Ratios (which may vary from time to time depending on the terms of the Agreement).

Note: The TBOC provides that, absent agreement to the contrary in the Agreement, it will be determined by the governing authority.

5.2 Prohibited Distributions. Distributions may not be made to the Members of the Company if, immediately after the making of the distribution, the liabilities of the Company will exceed the Fair Value of the Company's assets in the manner determined in Section 101.206 of the TBOC.

5.3 *Working Capital Reserve*. From time to time, the Managers, in their sole discretion, may establish and maintain a Working Capital Reserve. If and to the extent the Managers determine, in its sole discretion, that funds in the Working Capital Reserve that have not been utilized by the Company are no longer required to be so maintained, such funds will be released from the Working Capital Reserve and distributed in the manner in which they would have been distributed had they not been set aside to fund such Working Capital Reserve. The Managers will determine, in their sole discretion, the periods to which any funds released from the Working Capital Reserve are attributable.

Practice Comment: The need to maintain a working capital reserve is arguably greater if the Company does not provide for additional capital contributions. If you represent a Member who does not control management decisions, you may want some restrictions on the ability of the Managers to establish a reserve. Some examples of restrictions include linking the reserve to actual binding commitments that exist on the date the reserve is established that will come due within a specified period of time and capping the reserve at a specified percentage of cash flow for some period.

5.4 *Distribution in Kind*. No assets will be distributed in kind, regardless of any potential unrealized depreciation or appreciation in respect thereof. Any in-kind distributions will be made proportionately among the Members in accordance with the percentage of the distributions the Members are entitled to receive, as set out in this Agreement.

Practice Comment: §101.202 of the TBOC prohibits an in-kind distribution of assets unless the Company Agreement provides otherwise. Determine what is appropriate for the particular transaction and modify as appropriate.

5.5 *Allocation of Profits and Losses*. Profits and Losses for each Adjustment Period will be allocated among the Members in accordance with their Sharing Ratio as set out in this Agreement.

Practice Comment: Capital accounts are typically used to keep track of the economics of the Members for both tax and other purposes. If the Company Agreement fails to otherwise specify the manner in which profits and losses are to be allocated to the Members and if there is no Sharing Ratio specified in the Company's books and records, profits

and losses are allocated in proportion to the "**member's percentage or other interest**." It is unclear what this may mean.

Practice Comment: This is a very simple allocation provision that does not anticipate different priorities in either the Sharing Ratios or allocations of Profits and Losses. Please see your tax professional on issues relating to these allocations.

5.6 ***Special Allocations***. The following special allocations will be made in the following order before allocations of Profits and Losses are made:

Practice Comment: Some tax provisions have become almost standard.

5.7 ***Qualified Income Offset***. Notwithstanding any other provision of this Article, in the event any Member unexpectedly receives any adjustments, allocations, or distributions described in Regulations Sections 1.704(b)(2)(ii)(d)(4), 1.704-1(b)(2)(ii)(d)(5), or 1.704-1(b)(2)(ii)(d)(6) of the IRS Code, items of Company income and gain shall be specifically allocated to each such Member in an amount and manner sufficient to eliminate, to the extent required by the Regulations, the Adjusted Capital Account Deficit of such Member as quickly as possible, provided that an allocation pursuant to this Section shall be made if and only to the extent that such Member would have an Adjusted Capital Account Deficit after all other allocations provided for in this Article have been tentatively made as if this Section were not in the Agreement. For the purpose of this Agreement, the term Adjusted Capital Account shall mean that Member's Capital Account after (i) crediting to the Capital Account any amount which the Member is deemed to be obligated to restore pursuant to 1.704-1(b)(2)(g)(1) and 1.704-1(b)(2)(5), crediting to the Capital Account any sums the Member is unconditionally obligated to contribute to the Company, and (ii) debiting the items set out in 1.704(1)(b)(ii)(d)(4),(5) and (6). An Adjusted Capital Account Deficit means the deficit balance in such Adjusted Capital Account.

Practice Comment: If your capital account goes negative and you have no duty to make it up, you have to receive a gross income allocation to correct this problem.

5.8 ***Minimum Gain Chargeback***. Except as otherwise provided in Section 1.704-2(f) of the Treasury Regulations relating to the IRS Code, notwithstanding any other provision to this Article, if there is a net decrease in the Member's Minimum Gain during any Company fiscal year and it is required for the allocations under this Article to have substantial economic effect, each Member shall be specially allocated items of Company income and gain for such year (and, if necessary, subsequent years) in an amount equal to such Member's share of the net decrease in Members Minimum Gain, determined in accordance with Treasury Regulation Section 1.704-2(g). Allocations pursuant to the previous sentence shall be made in proportion to the respective amounts required to be allocated to each Member pursuant thereto. The items to be so allocated shall be determined in accordance with applicable Treasury Regulations. This Section is intended to comply with the minimum gain chargeback requirements of Section 1.704-2(f) of the Treasury Regulations and shall be interpreted consistently therewith.

5.9 ***Basis Adjustments***. To the extent an adjustment to the adjusted tax basis of any Company asset is required pursuant to IRS Code Section 732(d), Code Section 734(b), or

Code Section 743(b), the Capital Accounts of the Member will be adjusted pursuant to Section 1.704-1(b)(2)(iv)(m) of the Regulations.

5.10 ***Allocations Under Section 704(c) of the Code***. In accordance with IRS Section 704(c) and the Treasury Regulations promulgated thereunder, income, gain, loss, and deduction with respect to any asset contributed to the capital of the Company will, solely for tax purposes, be allocated among the Members so as to take account of any variation between the adjusted basis of such asset to the Company for federal income tax purposes and the Gross Asset Value of the property. Allocations under this Section 5.9 are solely for purposes of federal, state, and local taxes and will not affect, or in any way be taken into account in computing, any Member's Capital Account or share of Profits and Losses or other items or distributions under any provision of this Agreement.

5.11 ***Curative Allocations***. The allocations set forth in this Article 5 (the "Regulatory Allocations") are intended to comply with certain requirements of Regulations Sections 1.704-1(b). Notwithstanding any other provisions of this Article 5, the Regulatory Allocations shall be taken into account in allocating other Profits and Losses and items of income, gain, loss, and deduction among the Members so that, to the extent possible, the net amount of such allocations of other Profits and Losses, and other items and the Regulatory Allocations to each Member shall be equal to the net amount that would have been allocated to each such Member if the Regulatory Allocations had not occurred. The Managers shall have the discretion to make any modification to this Agreement deemed reasonably necessary to cause the allocations described in this Article 5 to more properly reflect the allocations intended hereunder, and each Member does hereby appoint each Manager, acting on pursuant to a proper determination of the Managers, to act as attorney-in-fact through a power of attorney coupled with an interest to do so.

5.12 ***Other Distribution and Allocation Rules***.

(i.) **Withholding.** Notwithstanding anything to the contrary contained in this Agreement, the Managers, in their sole discretion, may withhold from any distribution of Distributable Cash or other cash or other property to any Member contemplated by this Agreement any amounts due from such Member to the Company, or any other Member in connection with the business of the Company to the extent not otherwise paid. If any provision of the IRS Code, the Regulations, or state or local law or regulations requires the Company to withhold any tax with respect to a Member's distributive share of Company income, gain, loss, deduction, or credit, the Company will withhold the required amount and pay the same over to the taxing authorities as required by such provision. The amount withheld will be deducted from the amount that would otherwise be distributed to that Member, but will be treated as though it had been distributed to the Member with respect to which the Company is required to withhold. If at any time the amount required to be withheld by the Company exceeds the amount of money that would otherwise be distributed to the Member with respect to which the withholding requirement applies, then that Member will make a Capital Contribution to the Company equal to the excess of the amount required to be withheld over the amount, if any, of money that would otherwise be distributed to that Member and that is available to be applied against the withholding requirement. Each of the Members represent that each

such Member is not aware of any provision of the IRS Code, the Regulations, or state or local law or regulations that currently require withholding of any tax by the Company with respect to such Member.

(ii.) **Allocations Upon Transfers of Company Interests.** If the Sharing Ratios are increased or decreased by reason of the admission of a new Member or otherwise, then Profits and Losses for a fiscal year will be assigned pro rata to each day in the particular period of such fiscal year to which such item is attributable (*i.e.*, the day on or during which it is accrued or otherwise incurred) and the amount of each such item so assigned to any such day will be allocated among the Members based upon their respective interests in the Company at the close of such day. For the purpose of accounting convenience and simplicity, the Company will treat a Transfer of, or an increase or decrease in Membership Interest that occurs at any time during a semi-monthly period as having been consummated on the first day of such semi-monthly period, regardless of when during such semi-monthly period such Transfer, increase or decrease actually occurs (*i.e.*, Transfers or increases or decreases made during the first 15 days of any month will be deemed to have been made on the first day of the month and Transfers or increases or decreases thereafter will be deemed to have been made on the 16th day of the month).

(iii.) **Other Items.** Except as otherwise provided in this Agreement, all items of Company income, gain, loss, deduction, and other allocations not otherwise provided for will be divided among the Members in proportions to their Sharing Ratios for the period during which such items were allocated**.**

ARTICLE 6
MANAGEMENT; RIGHTS AND DUTIES OF MANAGERS

6.1 ***Management of Company Affairs***. The Company will have one or more Managers who will have the full, complete, and exclusive authority to manage and control the business, affairs, and properties of the Company, to make all decisions regarding those matters, and to perform any and all other acts or activities customary or incident to the management of the Company's business, all subject to any restrictions imposed by applicable law or expressly imposed by this Agreement. In addition to the powers now or hereafter granted, the Managers of a limited liability company under applicable law or that are granted the Managers under any provision of this Agreement, subject to the limitations described in Section 6.1 and elsewhere in this Agreement, the Managers will have the power, for and on behalf and in the name of the Company, to carry out and implement the purpose of the Company set forth in Section 2.6 and to do all things necessary or desirable or expedient in connection therewith or incidental thereto and to manage, conduct, and supervise the day-to-day business affairs of the Company and, without limiting the generality of the foregoing, to cause the Company to do the following:

(i.) to acquire, purchase, own, hold, maintain, develop, operate, sell, exchange, lease, sublet, assign, transfer, or otherwise dispose of tangible and intangible properties of any kind and character;

(ii.) to enter into, become bound by, and perform obligations under contracts and instruments and to make all decisions and waivers thereunder;

(iii.) **to** open, maintain, and close bank accounts, make withdrawals therefrom, and designate and change signatories on such accounts;

(iv.) to procure and maintain with responsible companies insurance, including general liability, bodily injury, and property damage insurance, in amounts that are available and that are generally carried by similar entities;

(v.) to incur all legal, accounting, investment banking, independent financial consulting, litigation, brokerage, registration, and other fees and expenses as it may deem necessary or appropriate for carrying on and performing the powers and authorities herein conferred;

(vi.) to collect amounts due the Company, settle claims, prosecute and defend lawsuits, and handle matters with governmental agencies;

(vii.) to exercise the voting rights of the Company on account of its ownership in any other Person; *provided howevever*, that if the action to be voted on is one that, if taken by the Company itself, would require the approval of the Members, such approval will be required before the Managers exercise such voting rights to approve such action;

(viii.) to borrow funds or otherwise commit the credit of the Company; and

(ix.) to make, constitute, and appoint, by written document duly executed and acknowledged, any Person who does not suffer any legal disability, contractual or otherwise, that would prohibit such Person from so acting, as the Company's true and lawful attorney and agent for it and in its name, place, and stead and for its use and benefit to perform any act or exercise any power or authority, all as specified in such document, that the Managers might perform or exercise in accordance with this Agreement; *provided*, *however*, that no such appointment will relieve the Managers of the duties and obligations imposed on them under this Agreement or the Company Act.

Practice Comment: Pursuant to §101.252 of the TBOC, where a Certificate indicates an LLC will be managed by Managers, the Managers have the right to manage and conduct the business of the Company.

Practice Comment: This list of specific authority is not required but it may be helpful if there are some specific actions with third parties who are likely to inquire as to authority. Consider modifying the list to add actions specific to the particular transaction.

Note: There is no longer a default to management by the managers since the matter must be addresses in the Certificate, no default was necessary.

6.2 ***Limitations on Powers and Authority of the Managers***. Notwithstanding the provisions of Section 6.1, the Managers may not cause the Company to do any of the following without the consent of a Majority of the Members:

(i.) do any act in violation of this Agreement;

(ii.) do any act that would make it impossible to carry on the ordinary business of the Company (except in connection with the winding up of the Company's business);

Practice Comment: The parenthetical phrase eliminates any ambiguities that may exist as to authority to take actions during winding-up that are inconsistent with carrying on the ordinary course of business such as, for example, selling of assets.

Note: The Members may want to add a provision which also limits the authority of the Managers on fundamental business transactions, such as a sale of all or substantially all of the assets of the Company. This is a default position under Section 101.356(c) of the TBOC, which reserves this to the Members. If so, be sure to define what a fundamental business transaction is to avoid problems in determining when this limitation applies.

(iii.) admit a Person as a Member except as otherwise expressly permitted by this Agreement;

Practice Comment: Unless the Company Agreement otherwise provides, after the Company is formed, the consent of all Members is required to admit a person as a Member. §§101.105(b) of the TBOC.

(iv.) possess Company property or assign its rights in Company property, other than for a Company purpose; or

(v.) amend this Agreement except as otherwise expressly permitted by this Agreement.

(vi.) any acts which require the prior approval of the Members.

Practice Comment: Unless the Company agreement otherwise provides, the consent of all Members is required to amend the Company agreement. *See* §§101.153 of the TBOC.

Practice Comment: Consider modifying this list to address any other areas of specific concern to the Members.

6.3 ***Reliance on Authority***. In its dealings with the Company, a third party may rely on the authority of the Managers to bind the Company without reviewing the provisions of this Agreement or confirming compliance with the provisions of this Agreement.

Practice Comment: This provision is intended to give comfort to a third party relying on the authority of the Managers but may be detrimental to the Members. *See* §101.254 of the TBOC provides authority for this as well.

6.4 ***Compensation***. Beginning as of the date of this Agreement, the Managers will be entitled to receive a Management Fee for their services provided in managing the Company and its operations. The Management Fee will be computed and payable as follows: _____ _____ _____ _____.

Practice Comment: If no compensation is to be paid to the Managers for acting as such, it is prudent to include an affirmative disclaimer to that effect to avoid misunderstandings.

6.5 ***Reimbursement***. The Managers are not required to advance any funds to pay costs and expenses of the Company. If the Managers do incur out-of-pocket costs and expenses in performing their duties under this Agreement, including the portion of its overhead costs and expenses that the Managers determine are allocable to the Company, the Managers are entitled to be reimbursed by the Company for such costs and expenses.

Practice Comment: If you represent a Member who is not involved as a Manager of the Company, you may want to place some limits or standards on reimbursements of expenses to assure the Managers are prudent as to these expenses and you may want to expressly exclude overhead costs as reimbursable expenses.

6.6 ***Standards of Performance***. Except as otherwise provided in this Agreement, the Managers will perform their duties with respect to the Company in good faith and will devote such time and effort to the Company business and operations as the Managers believe is reasonably necessary to manage the affairs of the Company prudently and only to the extent that the Company has the funds available to permit the Managers to perform such duties. The Managers and their respective affiliates, and all officers, directors, employees and agents acting in that capacity, shall not be liable to the Company or its Members for any losses sustained or liabilities incurred as a result of any act or omission of such Person, if they acted in good faith and in a manner it believed to be in, or not opposed to, the interests of the Company. In the event a question should arise as to a Manager regarding their liability in connection with their duties hereunder to the Company or another Member of the Company they shall have no more duty or liability in connection therewith than if they were acting as a member of the board of directors of a Texas company which was carrying out the duties and responsibilities of the corporation.

Practice Comment: A standard of performance by the Managers is not required, however, the Members who are not Managers may desire to have a statement included in the Company Agreement which addresses the responsibility of the Managers. If a standard is set out in the Company Agreement the provision should be coordinated with the provisions governing indemnification of the Managers to avoid inconsistent results. Section 101.401 of the TBOC makes clear that the Agreement may expand or restrict any duties, including fiduciary duties that may be owed by a member, manager, officer or other person to the Company.

Practice Comment: This provision does not hold a Manager liable for breaches of the Company Agreement. If liability were imposed on the Managers for breaches of the Company Agreement, the Managers could have liability for breaching any of the specific duties or limitations in the Company Agreement, even if the breach was caused by simple negligence. That may or may not be the intended result. However, remember Managers can always be removed.

Practice Comment: If you represent a Member who is not a Manager, you may want to provide a more stringent standard which holds Managers responsible for acts of gross negligence or violations of this Agreement.

ARTICLE 7
MEETINGS OF THE MANAGERS

7.1 ***Management.*** The powers of the Company shall be exercised by and under the authority of, and business and affairs of the Company shall be managed under the direction of, the Managers of the Company.

Practice Comment: Pursuant to §101.251 of the TBOC, where a Certificate indicates an LLC will be managed by Managers, the Managers have the right to manage and conduct the business of the Company.

7.2 ***Number; Qualification; Election; Term.*** The Managers shall consist of at least one (1), but not more than _____(__) Managers, none of whom need to be Members or residents of any particular state. The initial Managers are set out in the Certificate. Future or additional Managers shall be elected by a Majority of the Members, except as provided in Sections 7.3 and 7.5 of this Agreement. Each Manager elected shall hold office until his successor shall be elected and shall qualify.

7.3 ***Change in Number.*** The number of Managers may be increased or decreased from time to time by amendment to this Agreement only with the vote of a Majority of all the Members, but no decrease shall have the effect of shortening the term of any incumbent Manager. Any Manager's position to be filled by reason of an increase in the number of Managers shall be filled by election of a Majority of the Members.

Practice Comment: The TBOC provides that matters brought up at a special meeting are to be set out in a notice for that meeting. If you are not making a distinction between annual meetings and special meetings you may need to make clear when you want the notice to limit the nature of the called special meeting, if at all.

7.4 ***Removal.*** Any Manager may be removed either for or without cause at any meeting of Members, by the affirmative vote of a Majority of the Members if notice of intention to act upon such matter shall have been given in the notice calling such meeting.

Practice Comment: The TBOC provides that matters brought up at a special meeting are to be set out in a notice for that meeting. If you are not making a distinction between annual meetings and special meetings you may need to make clear when you want the notice to limit the nature of the called meeting.

7.5 ***Vacancies.*** Any vacancy occurring in the Managers by reason of the increase in the number of Managers, may be filled by vote of a Majority of the remaining Managers though less than a quorum of the Managers. A Manager elected to fill a vacancy shall be elected for the unexpired term of his predecessor in office.

7.6 ***Election.*** Each Manager shall be elected by the vote of a Majority of the Members at a meeting of Members at which a quorum is present.

7.7 ***Meetings.*** Regular meetings of the Managers shall be held annually on the _____ day of _____, or more often as may be determined by the Managers, from time to time. Meetings of the Managers may be called by the President or any Manager on three (3) days' notice to each Manager, either personally or by mail or by telegram. Except as otherwise expressly provided by this Agreement, neither the business to be transacted at, nor the purpose of, any meeting need be specified in a notice or waiver of notice.

Practice Comment: Section 101.352 (b) provides that the purpose of Special Meetings is to be set out in the notice for the Meeting. Consider if the parties desire to modify this arrangement, as set out above.

7.8 ***Place of Meetings.*** Meetings of the Managers may be held within or outside of the State of Texas

7.9 ***Quorum; Vote of a Majority of Managers***. At meetings of the Managers, a Majority of the number of Managers fixed by this Agreement shall constitute a quorum for the transaction of business. The act of a Majority of the Managers present at a meeting at which a quorum is present shall be the act of the Managers, except as otherwise specifically provided by statute, the Certificate. If a quorum is not present at a meeting of the Managers, the Managers present may adjourn the meeting from time to time, without notice other than announcement at the meeting, until a quorum is present.

Practice Comment: Note that the decisions of the Managers may be based upon a Majority of those present at a meeting at which a quorum is present. This may be less than a Majority of all of the Managers.

7.10 ***Notice of Meetings***. Notice stating the place, day and hour of the meeting shall be delivered to each Manager not less than three (3), nor more than sixty (60) days before the date of the meeting, by or at the direction of the Member or Members who called the meeting, the President, or other person calling the meeting. The actions or activities to be addressed at a meeting of the Managers (general or special) is not required to be set out in the notice. .

Practice Comment: If the Members want the matters which may arise at special meetings to be required to set out in the notice this should be set out in the Agreement.

Note: The TBOC sets out, in Section 6.051 how notice of meetings of Members and Managers is to be sent if not addresses in the Agreement.

7.11 ***Waiver of Notice***. Attendance of a Manager at a meeting shall constitute a waiver of notification of the meeting, except where such Manager attends for the express purpose of objecting to the transaction of any business on the ground that the meeting is not lawfully called or convened. Notification of a meeting may also be waived in writing. Attendance at a meeting is not a waiver of any right to object to the consideration of matters required to be included in the notification of the meeting but not so included, if the objection is expressly made at the meeting.

7.12 ***Minutes of Meeting.*** The Managers shall keep regular Minutes of its proceedings. The Minutes shall be placed in the records of the Company.

7.13 ***Action Without Meeting***. Any action that may be taken, or that is required by law or this Agreement to be taken by the Managers, or any group thereof, may be taken without a meeting, without prior notice, and without a vote, if a consent or consents in writing, setting forth the action so taken, will have been signed by the Managers whose consent is necessary to take the action. The consent may be in one or more counterparts. For purposes of this Section, a telegram, telex, cablegram, or similar transmission by a Person or a photographic, photostatic, facsimile, or similar reproduction of a writing signed by a Person will be regarded as signed by that Person. In any request for consent or approval from another Manager, the requesting Manager(s) may specify a response period, ending no earlier than the fifth day following the date on which the Manager whose consent or approval is sought receives the request. If the receiving Manager does not respond by the end of this period, it will be deemed to have not consented to or approved the action set forth in the request. The signed consent, or a signed copy, shall be placed in the Records of the Company.

Practice Comment: Section 101.358(b). Consider whether it would be preferable to provide that "failure to respond is the equivalent of consent being given rather than denied". Determine if this is a right that you want to provide to the Managers, or do you want to require any action taken without a meeting to be unanimous.

7.14 ***Action by Telephone Conference***. Members may participate in and hold a meeting by means of a conference telephone or similar communications equipment or other suitable electronic communications equipment, including video conferencing technology, or the internet, or a combination thereof, by means of which all Persons participating in the meeting can hear each other and participate in the meeting. Participation in such meeting will constitute attendance and presence in person at such meeting, except where a Person participates in the meeting for the express purpose of objecting to the transaction of any business on the ground that the meeting is not lawfully called or convened.

7.15 ***Proxies***. Managers are entitled to vote by and through a person holding a valid written proxy. A telegram, telex, cablegram, or similar transmission by the Manager, or a photographic, photostatic, facsimile, or similar reproduction of a writing executed by the Manager, shall be treated as an execution in writing for the purposes of this Agreement. No proxy shall be valid after eleven (11) months from the date of its execution, unless otherwise provided in the proxy. Each proxy shall be revocable unless expressly provided therein to be irrevocable and unless otherwise made irrevocable by law. Each proxy shall be filed with the Secretary of the Company prior to or at the time of the meeting

Practice Comment: This is a new right granted to Managers under Section 101.357. Consider whether it would be preferable to prohibit the use of Proxies by Managers.

ARTICLE 8
COMMITTEES

8.1 ***Designation***. The Managers may designate one or more committees, each of which shall be comprised of one or more Manager, and may designate one or more of its Managers as alternate participant of any committee, who may, subject to the limitations imposed by the Managers, replace absent or disqualified Managers at any meeting of that committee.

8.2 ***Authority.*** All committees, to the extent provided in such resolution, shall have and may exercise all of the authority of the Managers in the management of the business and affairs of the Company.

8.3 ***Term.*** All committees shall serve for the term appointed by the Managers.

8.4 ***Change in Number.*** The number of committee members of a particular committee may be increased or decreased from time to time by resolution adopted by the Managers.

8.5 ***Removal.*** Any member of a committee may be removed by the Managers.

8.6 ***Vacancies.*** A vacancy occurring on a committee (by death, resignation, removal or otherwise) may be filled by the Managers.

8.7 ***Meetings.*** Time, place and notice (if any) of a committee meeting shall be determined by the committee.

8.8 ***Quorum; Vote of a Majority***. At meetings of a committee, a Majority of the number of committee members designated by the Managers shall constitute a quorum for the transaction of business. The act of a Majority of the committee members present at any meeting at which a quorum is present shall be the act of the committee, except as otherwise specifically provided by statute, the Certificate or this Agreement. If a quorum is not present at a meeting of a committee, the committee members present may adjourn the meeting from time to time, without notice other than an announcement at the meeting, until a quorum is present. Each committee member shall have one vote. Committee members are entitled to vote by and through a person holding a valid written proxy. A telegram, telex, cablegram, or similar transmission by the Committee member, or a photographic, photostatic, facsimile, or similar reproduction of a writing executed by the Committee member, shall be treated as an execution in writing for the purposes of this Agreement. No proxy shall be valid after eleven (11) months from the date of its execution, unless otherwise provided in the proxy. Each proxy shall be revocable unless expressly provided therein to be irrevocable and unless otherwise made irrevocable by law. Each proxy shall be filed with the Secretary of the Company prior to or at the time of the meeting.

Practice Comment: This is a new right granted to Committee Members under Section 101.357. Consider whether it would be preferable to prohibit the use of Proxies by Committee Members.

8.9 ***Compensation.*** By resolution of the Managers, the members of a committee may be paid their expenses, if any, of attendance at each meeting of the committee and may be paid a fixed sum for attendance at each meeting of the committee or a stated salary as a member of the committee. No such payment shall preclude any committee member from serving the Company in any other capacity and receiving compensation therefore.

8.10 ***Procedure.*** Each committee shall keep regular minutes of its proceedings and report the same to the Managers when required. The minutes of the proceedings of a committee shall be placed in the records of the Company.

8.11 ***Action Without Meeting.*** Any action that may be taken, or that is required by law or this Agreement to be taken by the committee may be taken without a meeting, without prior notice, and without a vote, if a consent or consents in writing, setting forth the action so taken, will have been signed by the committee members whose consent is necessary to take the action. The consent may be in one or more counterparts. For purposes of this Section, a telegram, telex, cablegram, or similar transmission by a Person or a photographic, photostatic, facsimile, or similar reproduction of a writing signed by a Person will be regarded as signed by that Person. The signed consent, or a signed copy, shall be placed in the Records of the Company.

Practice Comment: Section 101.358(b). Consider whether it would be preferable to provide that "failure to respond is will either be deemed non consent (as is the case with Managers, as set out above), or the equivalent of consent being given rather than denied. Determine if this is a right that you want to provide to committee members or do you want to require any action taken without a meeting to be unanimous.

8.12 ***Telephone and Similar Meetings.*** Committee members may participate in and hold a meeting by means of conference telephone, similar communications equipment or other suitable electronic communications equipment, including video conferencing technology, or the internet, or a combination thereof, by means of which all Persons participating in the meeting can hear each other and participate in the meeting. Participation in such meeting will constitute attendance and presence in person at such meeting, except where a Person participates in the meeting for the express purpose of objecting to the transaction of any business on the ground that the meeting is not lawfully called or convened..

8.13 ***Responsibility.*** The designation of a committee and the delegation of authority to it shall not operate to relieve the Managers, or any member thereof, of any responsibility imposed upon it or him by law.

ARTICLE 9
OFFICERS AND AGENTS

9.1 ***Number; Qualification; Election; Term***. The Company may have a President, Secretary; and such other officers (including any Vice Presidents and a Treasurer) and assistant officers and agents as the Managers may deem necessary.

(i.) No officer or agent need be a Member, a Manager or a resident of Texas.

(ii.) Officers shall be elected by the Managers.

(iii.) Unless otherwise specified by the Managers at the time of election or appointment, or in an employment contract approved by the Managers, each officer's and agent's term shall end one year from the date of appointment or, if earlier, his death, resignation, or removal.

(iv.) Any two or more offices may be held by the same person.

9.2 ***Removal***. Any officer or agent elected or appointed by the Managers may be removed by the Managers. Election or appointment of an officer or agent shall not of itself, nor shall anything in this Agreement, create contract rights.

Note: Section 3.104(a). The default rule now applies to all entities, including LLC's. and does not require that the removal be in the best interest of the entity, as set out in earlier law.

9.3 ***Vacancies***. Any vacancy occurring in any office of the Company (by death, resignation, removal or otherwise) may be filled by the Managers.

9.4 ***Authority***. Officers and agents shall have such authority and perform such duties in the management of the Company as are provided in this Agreement or as may be determined by resolution of the Managers not inconsistent with this Agreement.

9.5 ***President***. If the Company should elect to have one, the President shall be the Chief Executive Officer of the Company; he shall preside at all meetings of the Members and Managers, shall have general and active management of the business and affairs of the Company, and shall see that all orders and resolutions of the Members and Managers are carried into effect. He shall perform such other duties and have such other authority and powers as the Managers may from time to time prescribe.

9.6 ***Vice Presidents***. If the Company should elect to have one, the Vice Presidents, if any, in the order of their seniority, unless otherwise determined by the Managers, shall, in the absence or disability of the President, perform the duties and have the authority and exercise the powers of the President. They shall perform such other duties and have such other authority and powers as the Managers may from time to time prescribe or as the President may from time to time delegate.

9.7 ***Secretary***. If the Company should elect to have one, the Secretary shall attend all meetings of the Managers and all meetings of the Members and record all votes, actions and minutes of all proceedings in the Records of the Company to be kept for that purpose and shall perform like duties for any committees when required. He shall perform such other duties and have such other authority and powers as the Managers may from time to time prescribe or as the President may from time to time delegate.

9.8 ***Treasurer***. If the Company should elect to have one, the Treasurer, if any, shall have the custody of the Company funds and securities, shall keep full and accurate accounts of receipts and disbursements of the Company, and shall deposit all funds and other valuables in the name and to the credit of the Company in depositories designated by the Managers. He shall perform such other duties and have such other authority and powers as the Managers may from time to time prescribe or as the President may from time to time delegate.

9.9 ***Compensation***. The compensation of officers and agents shall be fixed from time to time by the Managers.

ARTICLE 10
MEETINGS AND CONSENTS OF MEMBERS

Practice Comment: The provisions of this Article generally parallel those relating to shareholders of a corporation.

10.1 ***Voting Rights***. Where Members are to make a determination under the terms of this Agreement, each Member is entitled to one vote for each Unit they hold in the Company. Only a Person who has been admitted to the Company as a Member shall be entitled to vote. A Person who receives a Transfer of all or a portion of the Membership Interest, or any other rights of a Member, shall not be entitled to vote as a Member until he has been admitted to the Company as a Member.

Practice Comment: Sections 6.251 and 6.252 of the TBOC have extended to the Members the right to create Voting Trusts and enter into Voting Agreements.

10.2 ***`Voting List****. At least ten (10) days before each meeting of the Members, a* complete list of the Members entitled to vote at the meeting, with the address of each and the number of Units held by each, shall be prepared by the Secretary. The list, for a period of ten (10) days prior to the meeting, shall be kept on file at the registered office of the Company and shall be subject to inspection by any Member at any time during usual business hours.

10.3 ***Record Date.*** The date upon which the notice of a meeting of the Members is mailed shall be the record date for the purpose of determining the Members entitled to vote at the Meeting. The record date for determining Members entitled to consent to action in writing without a meeting shall be the first date on which a written consent setting forth the action taken or proposed to be taken, is first delivered to the registered office, its principal place of business, or an officer or agent of the Company.

10.4 ***Method of Voting*****.** At any meeting of the Members, every Member having the right to vote may vote either in person, or by proxy executed in writing by the Member. A telegram, telex, cablegram, or similar transmission by the Member, or a photographic, photostatic, facsimile, or similar reproduction of a writing executed by the Member, shall be treated as an execution in writing for the purposes of this Agreement. No proxy shall be valid after eleven (11) months from the date of its execution, unless otherwise provided in the proxy. Each proxy shall be revocable unless expressly provided therein to be irrevocable and unless

otherwise made irrevocable by law. Each proxy shall be filed with the Secretary of the Company prior to or at the time of the meeting.

10.5 ***Meetings***. At any time, either the Managers or Members owning Units entitling them to at least 10% of the Units of all Members may call a meeting of the Members to transact business that the Members or any group of Members may conduct as provided in this Agreement. A meeting may be called by notice to all Members entitled to vote at such meeting on or before the tenth (10^{th}) day prior to the date of the meeting specifying the location and the time and stating the business to be transacted at the meeting. The chairperson of the meeting will be a Member selected by a Majority of the Members. At the meeting, the Members may take any action whether or not included in the notice of the meeting. Unless otherwise provided in this Agreement, all decisions of the Members shall be determined by a Majority of the Members.

10.6 ***Notice***. Written or printed Notice stating the place, day and hour of the meeting shall be delivered not less than ten (10) nor more than sixty (60) days before the date of the meeting, either personally or by mail, by or at the direction of the President, the Secretary, or the officer or person calling the meeting, to each Member of record entitled to vote at the meeting.

10.7 ***Waiver of Notice***. Attendance of a Member at a meeting shall constitute a waiver of Notification of the meeting, except where such Member attends for the express purpose of objecting to the transaction of any business on the ground that the meeting is not lawfully called or convened. Notification of a meeting may also be waived in writing. Attendance at a meeting is not a waiver of any right to object to the consideration of matters required to be included in the Notification of the meeting but not so included, if the objection is expressly made at the meeting.

10.8 ***Place of Meetings.*** Meetings of the Members may be held in or out of the State of Texas.

10.9 ***Action Without Meeting***. Any action that may be taken, or that is required by law or this Agreement to be taken, by the Members or any group thereof, may be taken without a meeting, without prior notice, and without a vote, if a consent or consents in writing, setting forth the action so taken, will have been signed by the Member(s) whose consent is necessary to take the action. The consent may be in one or more counterparts. In any request for consent or approval from another Member, the requesting Member(s) may specify a response period, ending no earlier than the fifth day following the date on which the Member whose consent or approval is sought receives the request. If the receiving Member does not respond by the end of this period, it will be deemed to have not consented to or approved the action set forth in the request.

Practice Comment: Section 6.202 indicates the ability to provide a consent by only those required to carry the vote will need to be set out in the Certificate; however this requirement is overridden by the provisions of 101.358(b). Determine if this is a right that you want to provide to the Members, or do you want to require any action taken without a meeting to be unanimous.

Practice Comment: . Consider whether it would be preferable to provide that failure to respond is the equivalent of consent being given rather than denied.

10.10 ***Action by Telephone Conference***. Members may participate in and hold a meeting by means of a conference telephone, similar communications equipment or other suitable electronic communications equipment, including video conferencing technology, or the internet, or a combination thereof, by means of which all Persons participating in the meeting can hear each other and participate in the meeting. Participation in such meeting will constitute attendance and presence in person at such meeting, except where a Person participates in the meeting for the express purpose of objecting to the transaction of any business on the ground that the meeting is not lawfully called or convened.

ARTICLE 11
CONTRACTS WITH RESTATED PARTNERS AND INDEMNIFICATION OF MEMBERS, MANAGERS AND OFFICERS

Practice Comment: Section 101.255 generally governs contracts with parties related to the Company to the extent not addressed by the Agreement. The parties should consider how strict the policy of the Company should be for contracts with related parties and set out these terms in the Agreement accordingly.

11.1 ***Interested Managers, Officers and Members***. If Section 11.2 is satisfied, no contract or other transaction between the Company and any of its Members, Managers, or officers or any company or firm in which any of them are directly or indirectly interested, shall be invalid solely because of their relationship with the Company or because of the presence of the Member, Manager, or officer at the meeting authorizing the contract or transaction, or his participation or vote in the meeting or authorization.

11.2 ***Disclosure, Approval; Fairness***. Paragraph (a) of this Section shall apply only if (X) the material facts of the relationship or interest of each such Member, Manager, or officer are known or disclosed:

(i.) to the Managers, and they nevertheless authorize or ratify the contract or transaction, provided however, while any such interested Manager shall be counted in determining whether a quorum is present, their vote shall not be calculated in determining the Majority necessary to carry the vote; or

(ii.) to the Members, and they nevertheless authorize or ratify the contract or transaction by, each such interested person to be counted for quorum and voting purposes; or

(Y) if the contract or transaction is fair to the Company as of the time it is authorized or ratified by the Managers or the Members, as the case may be.

11.3 ***Indemnifications***. The Company agrees to indemnify, defend, and hold harmless each of the following:

(i.) The Members, Managers and officers of the Company as well as their officers, managers, members, partners, owners, employees, and agents, (the "Indemnified Person") if any, from and against all Claims they may incur as a result of having been, being, or threatened to be made a named defendant or respondent in a Proceeding because it is or was a Member, Manager or officer in the Company or is performing or had performed the obligations of the Member, Manager or officer with respect to the Company, SPECIFICALLY INCLUDING CLAIMS BASED ON OR ARISING FROM THEIR SOLE, PARTIAL, OR CONCURRENT NEGLIGENCE, but excluding any such items incurred as a result of acts of gross negligence, willful or intentional acts against the Company.

(ii.) Each Indemnified Person from and against all Claims such Person may incur as a result of appearing as a witness or other participation in a Proceeding that involves or affects the Company;

(iii.) Each Indemnified Person from and against all Claims such Person may incur as a result of having performed or performing services for the Company, SPECIFICALLY INCLUDING CLAIMS BASED ON OR ARISING FROM THE INDEMNIFIED PERSON'S SOLE, PARTIAL, OR CONCURRENT NEGLIGENCE.

(iv.) The rights of an Indemnified Person under this Section include the right to be paid or reimbursed by the Company for reasonable expenses incurred in defending any Proceeding in advance of its final disposition.

(v.) If a claim for indemnification or advancement of expenses hereunder is not paid in full by the Company within 90 days after a written claim has been received by the Company, the Person seeking a remedy under this Section may at any time thereafter bring suit against the Company to recover the unpaid amount of the claim, and if successful in whole or in part, the Person seeking a remedy under this Section will also be entitled to be paid the expenses of prosecuting such claim.

(vi.) The right of any Indemnified Person under this Section will survive the termination of that Person's status as an Indemnified Person and the termination of this Agreement and the dissolution of the Company.

(vii.) In the event of the death of a Person seeking a remedy under this Section, the right under this Section will inure to the benefit of such Person's heirs, executors, administrators, and personal representatives.

(viii.) The rights conferred in this Section will not be exclusive of any other right that a Person seeking a remedy under this Section may have or hereafter acquire under any statute, resolution of Members, Managers agreement, or otherwise.

Practice Comment: Certain rights to indemnification for companies are governed by Title 1, Chapter 8, of the TBOC. Limited Liability Companies are not constrained by limits that might otherwise apply to corporations. This duty to indemnify has been drafted in a manner which is expansive.

Practice Comment: If you represent a Member who is not a Manager, you may want to consider limiting the

obligations of the Company to indemnify the Managers, as contemplated by §§8.003 of the TBOC, or even more so.

ARTICLE 12
RIGHTS, OBLIGATIONS,
AND REPRESENTATIONS OF MEMBERS

12.1 ***Representations of Members***. Each Member hereby severally represents and warrants to, and agrees with, the Company and each other Member as follows:

Practice Comment: The representations and warranties of each Member, if included, might also be tailored to address any specific concerns, including, for instance, the nature of title to any property to be contributed by a Member to the Company.

(i.) Such Member has full power and authority to execute and deliver this Agreement, to perform the obligations of such Member hereunder, and to consummate the transactions contemplated hereby. The execution, delivery, and performance of this Agreement by such Member, and the consummation by such Member of the transactions contemplated hereby, have been duly authorized and approved by such Member. This Agreement has been duly executed and delivered by such Member and is a valid and binding obligation of such Member, enforceable against such Member in accordance with its terms, except to the extent that its enforceability may be subject to applicable Bankruptcy Laws and to general equitable principles. The execution and delivery of this Agreement does not, and the consummation of the transactions contemplated hereby will not, violate any provision of any agreement, instrument, order, regulation, judgment, or decree to which such Member is subject or by which such Member or any asset of such Member is bound. Such Member is under no legal disability, contractual or otherwise, that prohibits such Member from entering into this Agreement and performing the obligations of such Member hereunder. Such Member is the sole party in interest in the Units of such Member under this Agreement and, as such, is vested with all legal and equitable rights in such Units.

(ii.) Such Member is acquiring the Units of the Company for the account of such Member and not with a view to distribution thereof within the meaning of the Securities Act of 1933, as amended, or any state securities laws. The Member will not Transfer the Units in contravention of that act or any applicable state or Federal securities laws.

Practice Comment: Because Company Membership Interest may be securities, it is likely that a representation of some sort will be necessary to confirm the exemption(s) from registration under federal and state securities laws on which the issuer is relying. The foregoing language should be modified to incorporate the relevant standards for such exemption(s).

(iii.) Such Member acknowledges and understands that the Managers are granted broad discretion and authority under this Agreement and that the Managers' exercise of such broad discretion and authority may impair the value of such Member's

Membership Interest. Such Member further acknowledges and understands that the Managers would not cause the Company to issue Membership Interest to the Member if the Managers did not have such broad discretion and authority and such Member agrees not to challenge the Manager's exercise of such discretion and authority.

Practice Comment: This language is intended to strengthen the Manager's defense against any limited Member who seeks to challenge the Manager's broad authority. If this is not the desire of the Members, this Section should be modified accordingly.

(iv.) Pursuant to the Texas Securities Act, Art. 581-1 et seq. (the "*Texas Securities Act*"), the liability under the Texas Securities Act of a lawyer, accountant, consultant, the firm of any of the foregoing, and any other Person engaged to provide services relating to an offering of securities of the Company (such Persons, "*Service Providers*") is limited to a maximum of three times the fee paid by the Company or seller of the Company's securities to the Service Provider for the services related to the offering of the Company's securities, unless the trier of fact finds that such Service Provider engaged in intentional wrongdoing in providing the services. By signing below, each Member hereby acknowledges the disclosure provided in this paragraph.

Practice Comment: This language is included to take advantage of the limitation on liability permitted by the Texas Securities Act. It may be prudent to have it also included in the subscription agreement, if any, initialed in the Company agreement, or otherwise singled out to avoid a claim that the limited Member did not notice it.

ARTICLE 13
BANK ACCOUNTS, INVESTMENTS, GENERAL ACCOUNTING PROVISIONS, REPORTS, AND DETERMINATION OF FAIR VALUE

13.1 ***Books of Account; Access; Fiscal Year***. The Managers, at the expense of the Company, shall maintain for the Company those books and records required by Section §3.151 and §101.501 of TBOC and such other books and records of account as the Managers, in their reasonable discretion, deem appropriate. Books and records of the accounts of the Company shall be maintained on a basis consistent with appropriate provisions of the IRS Code [as well as generally accepted accounting principles], containing, among other entries, a Capital Account for each Member.

Practice Comment: If the parties do not want the minutes of meetings of the Members or Managers or Committees to be a part of the records available for review, these can be excluded. Section TBOC 3.151(b).

13.2 ***Access to Books and Records***. Books of account are to be kept at the principal office of the Company. Except as set out herein, the Managers may restrict the access of one or more Members to certain books, records, and accounts to the extent the Managers believes it to be in the best interest of the Company to do so. The Managers may require any Person to whom confidential information of the Company is provided pursuant to this Section to

maintain the confidentiality of such information on such terms as the Managers may prescribe. The above notwithstanding:

(i.) The Company shall make available to a Member, or Assignee, at its registered office, the address of the principal office of the Company;

(ii.) The Company shall make available to a Member or Assignee, within five (5) days following their delivery of written request, each of those items required to be maintained under Section 3.152 and 101.502 of the TBOC and such other information regarding the business of the Company that is reasonable for the person to examine and copy;

(iii.) The Company shall make available to a Member or Assignee free of cost, the Certificate, this Agreement with all amendments, and the last 6 years Federal tax returns; and

(iv.) The Company shall make available to a Manager or Committee Member and records pursuant to §3.151, 3.152 and 3.153 of the TBOC and such other information regarding the business of the Company that is reasonably related to the persons services.

Practice Comment: The Company is required to provide to Members and former Members access to the Company's books and records pursuant to §3.151, 3.152 and 3.153 of the TBOC. Under certain circumstances, Managers may believe that a Member's access to the Company's records could be detrimental to the Company, particularly if the Member is a competitor or is otherwise likely to use the information to disadvantage the Company. §3.153 of the TBOC.

Practice Comment: If you represent a Member who is not a Manager, you may want to limit the ability of the Managers to restrict access to the books and records of the Company if you are concerned the restriction is more to protect the Managers than the Company.

Practice Comment: Section 3.152 of the TBOC adds a right for governing persons to have appropriate and adequate access to those books and records set out in §3.153 of the TBOC or otherwise reasonably related to the persons services.

13.3 ***Annual Reports***. As soon as reasonably practicable after the end of each Fiscal Year, the Managers will use commercially reasonable efforts to cause the Members to be furnished with a balance sheet, an income statement, and a statement of changes in Members' capital of the Company for, and as of the end of, such year. These financial statements shall be certified by certified public accountants chosen by the Managers pursuant to a compilation [review] [audit] of the financial records of the Company conducted by the certified public accountants. The Managers also may cause to be prepared or delivered such other reports as it may deem appropriate. The Company will bear the costs of such reports.

Practice Comment: If you represent a Member who is not a Manager, you may want the Managers to have an absolute requirement to produce these reports by a date certain.

13.4 ***Periodic Reports***. As soon as reasonably practicable within fifteen (15) days following the end of each quarter [month] during the Fiscal Year, the Managers will use commercially reasonable efforts to cause the Members to be furnished with a balance sheet, and an income statement, as of the end of, such period reflecting the information for that period of the Fiscal Year, as well as, a year to date presentation of that information. These financial statements may be created internally by the Company, or, at the sole discretion of the Managers, prepared by certified public accountants chosen by the Managers. The Managers also may cause to be prepared or delivered such other reports as it may deem appropriate. The Company will bear the costs of all such reports.

13.5 ***Reliance on Third Party Reports*****.** In connection with the discharge of their duties under the terms of this Agreement, or the exercise of their powers, Managers, Committee Members and Officers of the Company shall have the right to rely upon information, opinions, reports and statements, including financial statements and other financial data concerning the Company or another Person presented by an officer, employee, legal counsel, certified public accountant, investment banker, committee of which they are not a member, or other person they reasonably believe possess professional expertise in the matter, unless they have knowledge of matters that would make this reliance unwarranted.

13.6 ***Bank Accounts***. The Managers will establish and maintain, in the name of the Company, one or more accounts at one or more banks. All Company funds will be deposited into such account(s). No other funds will be deposited into any such account. Funds deposited in any such account may be withdrawn only to pay Company debts or obligations, to make distributions to the Members pursuant to this Agreement, or to make Permitted Investments.

13.7 ***Permitted Investments***. Company funds may be invested in such investments as the Managers determine.

Practice Comment: If you represent a Member who is not a Manager, you may want some restrictions on the types of investments the Managers may make.

13.8 ***Audits at Request of Member****.* Any Member shall have the right to have a compilation, review or audit conducted of the Company books (the "Audit"), which may be requested with respect to the annual financial statements of the Company. The cost of the Audit shall be borne by the Member or Members requesting the performance of the Audit. The Audit shall be performed by an accounting firm which provides accounting services for the Company. Not more than one (1) Audit shall be required by any or all of the Members for any fiscal year.

ARTICLE 14
TAXES

14.1 ***Tax Returns***. The Managers will use commercially reasonable efforts to cause to be prepared and filed all necessary federal and state income tax returns for the Company. Each Member will furnish to the Managers all pertinent information in its possession relating to Company operations that is necessary to enable the Company's income tax returns to be prepared and filed.

Practice Comment: Again, if you represent a non Managing Member, you may want the Managers to have an absolute requirement to produce these returns by a date certain.

14.2 ***Tax Elections***. The Company will make those tax elections the Managers may deem appropriate and in the best interests of the Members. The above notwithstanding, neither the Company nor any Member may make an election for the Company to be excluded from the application of the provisions of subchapter K of chapter 1 of subtitle A of the IRS Code or any similar provisions of applicable state law.

14.3 ***Tax Matters Partner***. The Managers will appoint one of the Managers to be the "tax matters partner" of the Company pursuant to section 6231(a)(7) of the IRS Code and may change the tax matters partner from time to time as they may determine necessary. In the event the Person appointed as the tax matters partner shall be removed, resign this position or no longer qualify, a Majority of the Members shall designate another Manager to be the "tax matters partner" of the Company pursuant to section 6231(a)(7) of the IRS Code. Any Manager who is designated "tax matters partner" shall take such action as may be necessary to cause each Member to become a "notice partner" within the meaning of section 6223 of the IRS Code. Any Manager who is designated "tax matters partner" shall inform each Member of all significant matters that may come to its attention in its capacity as "tax matters partner" by giving notice thereof as soon as reasonably possible.

Practice Comment: If you represent a non Managing Member, you may want to place certain restrictions on what the Managers may do as a tax matters partner and to require your client to receive copies of correspondence received by the Managers in its capacity as a tax matters Member.

ARTICLE 15
RESTRICTIONS ON CERTAIN TRANSFERS AND COMPETITIVE ACTIVITIES

15.1 ***General Prohibition***. No Person will make or suffer any Transfer of all or any part of its Membership Interest, whether now owned or hereafter acquired, except (i) without the approval of a Super Majority of the Members, (ii) in accordance with the terms of this Agreement to Permitted Transferees, or (iii) upon divorce, death [or disability] of the Member, and any purported Transfer not made in compliance with this Agreement will be void and of no force and effect.

Practice Comment: The restrictions on transfer and substitution in this Article give Members comfort that they will not be forced to be Members with someone unacceptable.

Practice Comment: Note that the restriction relates to any person and not just to Members. This is necessary because of the possibility that someone will own a Membership Interest as a mere assignee.

Practice Comment: If you represent a Member who is not a Manager, you may want to restrict the ability of the Members who are Managers to transfer its interest in the Company because you want the Managers economically motivated to manage the Company. Frequently, the Managers are given the right to transfer to an affiliate without the consent of the other Members but a consent is needed for all other transfers.

15.2 ***Rights of an Assignee*****.** Unless and until an Assignee becomes a Member of the Company in the manner herein prescribed, such Assignee shall be entitled only to receive distributions of the Company to which the assigning Member would otherwise be entitled and, as provided in the TBOC, to require reasonable access to the those books and records of the Company as set out in Section §3.151 and §101.501 of TBOC. In the event that the Members make additional contributions to the Company at any time while there is a Membership Interest held by an Assignee, the Member who assigned its Membership Interest in the Company and such Assignee, shall be jointly and severally responsible and required to make a contribution to the Company which relates to the Membership Interest. If the transferor Member or such Assignee does not make such contribution in accordance with the provisions of this Agreement, the transferor Member and the Assignee shall be treated as having Defaulted. In the event that one or more new Members are admitted into the Company, or one or more Members increase their interest in the Company while there is an outstanding interest in the Company held by an Assignee, and the Membership Interest of the then existing Members in the Company are reduced, the Membership Interest assigned to the Assignee shall be correspondingly reduced. No consent or other action on the part of such Assignee shall be required. The Units in the Company which relate to the Membership Interest so assigned shall **not** be considered in any Company voting requirements. Moreover, any Assignee of such interest who has not been admitted as a Member of the Company shall have no rights relative to the operations or management of the Company and in no event shall be construed as a Member for any reason.

Practice Comment: This provision further identifies and limits the rights of an assignee under Section 101.109 of the TBOC. 101.109 would allow access to reasonable information.

15.3 ***Transferor's Responsibility.*** In the event a transfer is made in accordance with the terms of this Article and the transferee is substituted as a Member in place of the transferor, the transferee who is substituted as a Member shall become liable for all the terms, covenants, conditions and obligations relating to the Membership Interest. In addition, the transferor, and its predecessors who have conveyed the Membership Interest in the Company shall, in no event be relieved of their liability, responsibility or obligations relating to such Membership Interest for any matters which may have arisen on or prior to the date of the transfer.

15.4 ***Substituted Members***. Unless otherwise provided in this Agreement, an Assignee of a Member may become a substituted Member only with the consent of a Super Majority of the Members other than the transferring Member. In the event such a consent is provided, the Assignee shall become a Member only upon the following:

(i.) The Member or the transferee has filed with the Company a written and dated instrument of such transfer, in form and substance reasonably satisfactory to the Managers, executed by both the transferor and the transferee, which instrument shall (i) contain the acceptance by the transferee of all of the terms and provisions of this Agreement, to the extent applicable to an assignee of a Membership Interest, (ii) contain such representations as the Managers may deem necessary or advisable to assure that such transfer need not be registered under any applicable federal or state securities laws, (iii) instruct the Managers as to the Membership Interest transferred and to whom

and at what address Company distributions and Notices in respect of such Membership Interest should be sent.

(ii.) Unless expressly waived by the Managers, the transferor or transferee shall have delivered to the Company an opinion of counsel acceptable to the Managers that (i) such Disposition is exempt from the registration requirements of the Securities Act, applicable state securities laws, and any rules or regulations promulgated thereunder, and will not otherwise cause the Company to be in violation of such laws and regulations, (ii) the Disposition will not result in the termination of the Company within the meaning of Section 708(b) of the IRS Code, and (iii) the Disposition will not adversely affect the status of the Company as a partnership under the IRS Code, and

(iii.) The transferee or assignee shall have paid or caused to be paid to the Company any reasonable expenses incurred by the Company in connection with the admission of the transferee or assignee as a Substitute Member.

The above notwithstanding, in the event of a Transfer to an existing Member, the existing Member shall automatically be deemed to be a Substitute Member and shall be deemed to have agreed to those items set out in subsection (a) above.

Practice Comment: Absent a provision in the Company agreement concerning substitution of Members, unanimity of Members is required to authorize a substitution. *See* §101.103(c) and §101.105 of the TBOC. This might also be approved by a Super Majority of the Members (including the transferring Member, Members holding a Majority of the Units, or some other arrangement that best suits the needs of the parties to the transaction.
Practice Comment: If certain transfers are exempted from the restrictions on transfers, consider whether they should also be exempted from these substitution requirements.
Practice Comment: Remember that an assignment does not, by itself, cause a substitution. A substitution must be addressed as a matter separate and apart from a mere assignment. Failure to handle this issue properly can result in the "wrong" people being Members.
Practice Comment: The parties may want to consider allowing a transfer of a Membership Interest but only in connection with either a right of first refusal or right of first offer. If the other Members do not purchase the Membership Interest then the Membership Interest can be transferred. The Company Agreement may want to go so far as to also agree to admit any such transferee as a Member.

ARTICLE 16
BUY OUT RIGHTS

16.1 ***Right to Purchase Upon Death [or Disability]***. Following a Transfer by such Member (the "Transferring Member") of its Membership Interest as a result of death or [disability], the Managers shall provide each of the other Members notice of such Transfer (the "Transfer Notice"). The other Members will have the right to purchase all or a portion of the Transferring Member's Membership Interest (the "Transferred Interest") for its Fair Value determined as of the date of the Notification Date (as set in this paragraph). Such right may be exercised by any one or more of the other Members giving, within ninety (90) days after such Transfer, to the Transferring Member (or its heirs, representatives, or assigns) notice of its desire to purchase all or a portion of such Transferred Interest (the "Notification Date"). If a Member provides a timely notice to purchase all or any portion of the Transferred Interest, as

soon as possible thereafter, the Company shall cause the Fair Value of the Transferred Interest to be determined as of the Notification Date. If there is more than one Member who desires to exercise such right (each, a "Purchasing Member"), the Transferred Interest will be allocated among all Purchasing Members as follows: First, a portion of the Transferred Interest will be allocated to each Purchasing Member to the extent of the lesser of (i) the Purchasing Member's pro rata portion (based on the number of Units owned by such Purchasing Member relative to the number of Units of all Purchasing Members) of the Transferred Interest and (ii) the portion of the Transferred Interest that such Purchasing Member expressed a desire to purchase in such notice. If, after such allocation, any portion of the Transferred Interest has not been allocated to the Purchasing Members (the "Residual Transferred Interest"), a similar allocation will be made of the Residual Transferred Interest among the Purchasing Members who have not been allocated the full portion of the Transferred Interest that such Purchasing Members expressed a desire to purchase in their respective notices. Such procedure will be continued until all of the Transferred Interest has been fully allocated, if possible.

Practice Comment: If this is to apply to the disability of a member you may want this to apply only to a member that is a manager since the disability of a Member that is [passive may have no effect on operations. In addition the Agreement will need to include a definition of when a disability arises and a procedure to determine if a disability exist.

Practice Comment: This pro rata allocation is made on the basis of the number of Units they hold. It may be more appropriate to base it on the Sharing Ratios at the time of the purchase.

16.2 ***Right to Purchase Upon Divorce***. If, as a result of divorce, a Transfer of a Membership Interest (the "Divorced Spouse Interest") takes place to the spouse of the person who is or was a Member (the "Spouse"), the Member who was divorced will have the right to purchase the Divorced Spouse Interest for its Fair Value determined as of the date of the Transfer. Such right may be exercised by the Member who was divorced giving, to (i) Spouse and (ii) each of the other Members, notice of a desire to purchase all or a portion of such Divorced Spouse Interest within _____ months after such Transfer (the "Initial Notice"). The date of the timely delivery of that Initial Notice is hereinafter referred to as the Initial Notification Date. If, after the delivery of the Initial Notice, the Member who was divorced has not given notice to purchase all or a portion of such Divorced Spouse Interest, the other Members will have the right to purchase the portion of the Divorced Spouse Interest with respect to which the Member who was divorced did not give such notice (the "Residual Divorce Interest") for its Fair Value determined as of the date of the Transfer. Such right may be exercised by the other Members giving, within _____ months after their receipt of the Initial Notice, a written notice of their desire to purchase all or a portion of such Residual Divorce Interest. If a Member provides a timely notice to purchase all or any portion of the Divorced Spouse Interest, as soon as possible thereafter, the Company shall cause the Fair Value of the Divorce Spouse Interest to be determined as of the Transfer Date. If there is more than one Member who desires to exercise such right (each, a "Purchasing Member"), the Residual Divorce Interest will be allocated among all Purchasing Members as follows: First, a portion of the Residual Divorce Interest will be allocated to each Purchasing Member to the extent of the lesser of (i) the Purchasing Member's pro rata portion (based on the number of Units owned by such Purchasing Member relative to the number of Units of all Purchasing Members) of the Residual Divorce Interest and (ii) the portion of the Residual Divorce Interest that such Purchasing

Member expressed a desire to purchase in such notice. If, after such allocation, any portion of the Residual Divorce Interest has not been allocated to the Purchasing Members, a similar allocation will be made of the remaining Residual Divorce Interest among the Purchasing Members who have not been allocated the full portion of the Residual Divorce Interest which such Purchasing Members expressed a desire to purchase in their respective notices. Such procedure will be continued until all of the Residual Divorce Interest has been fully allocated, if possible.

Practice Comment: This pro rata allocation is made on the basis of the number of Units they hold. It may be more appropriate to base it on the Sharing Ratios at the time of the purchase.

16.3 ***Fair Value Determination***. In the event the Fair Value of a Membership Interest is to be determined under the terms of this Agreement, the Managers shall cause the Company to select a qualified appraiser for the purpose of making such determination. In connection with any determination of Fair Value, the Company will make its books and records available to the appraiser and will otherwise cooperate and cause its employees to cooperate with such appraiser. The Company will pay the fees and expenses of such appraiser. In each case, the Managers will cause the appraiser to be selected in accordance with the time frames set out in the Section of this Agreement which calls for the Fair Value determination. The determination of Fair Value, made by such independent appraiser will be final, conclusive, and binding on the Company, all Members, and all Assignees of a Membership Interest. Upon receipt of the determination of the Fair Value the Company shall cause the report or reports developed by the appraisers to be distributed to each of the Members as soon as reasonably possible thereafter.

Practice Comment: Often the parties want the ability to participate in the selection of the appraiser to assure a level of fairness to the selection process. In this case it is not uncommon for the parties to attempt to agree on one appraiser, and only if they are not able to (within a set period of time), the buyer and seller will each select an appraiser, each at their own cost, and either those appraisers will select a third appraiser who will conduct the analysis (and the cost split between the buyer and seller) or, they will <u>all</u> conduct the analysis and the two closest in value will be averaged to determine the Fair Value. It is also not uncommon to include some level of instruction for the appraisers, such as a requirement that they take into consideration any discounts for minority control, or lack of marketability, or a requirement that any such discounts be ignored.

16.4 ***Termination Right.*** The above notwithstanding, in the event a Member exercises an election to purchase a Membership Interest under the terms of this Article 16.1 or 16.2, the Member may terminate its purchase right within fifteen (15) days following its receipt of the determination of the Fair Value, by delivery of Notice to the party selling the Membership Interest and the Company. If such election is terminated each of the other Members electing to purchase the Membership Interest will have the pro rata right to purchase that interest in the manner set out above.

16.5 ***Securities Laws Compliance***. The Membership Interest has not been registered with the Securities and Exchange Commission under the Securities Act of 1933, as amended, or the state securities laws of Texas or any other state. Without such registration, no Member or Assignee may effect or suffer a Transfer until the Member or Assignee provides evidence satisfactory to the Managers which, in the discretion of the Managers, may include an opinion of counsel satisfactory to the Managers, that such registration is not required for such

Transfer to the effect that any such Transfer will not be in violation of the Securities Act of 1933, as amended, applicable state securities laws, or any rule or regulation promulgated thereunder.

16.6 ***Closing***. If one or more Members elect to purchase the Membership Interest under the terms of this Article, the Closing shall be on or before that date which is the later of thirty (30) days after (i) the Notification Date or (ii) the determination of the Fair Value under the terms of this Agreement. At the Closing, the Person selling the Membership Interest will transfer the Membership Interest to be sold to the Member or Members purchasing the Membership Interest, free and clear of any liens or encumbrances (other than those which may have been created to secure any indebtedness or obligations of the Company). At the Closing, the purchase price to be paid for the Membership Interest shall be paid to the Person selling their interest, in cash.

Practice Comment: You may want to consider arranging the payment in installments. If so, the Agreement will need to set out the nature of the installment payments, an interest factor for the delayed payments and security for the payment of these sums. You should also address the prepayment of the installment obligation if all or substantially all of the assets of the Company are sold.

16.7 ***Third Party Offer***. In the event a Member (the "Selling Member") desires to sell all or any portion of its Membership Interest to a person or entity other than an existing Member or a Permitted Transferee of the Member it shall first offer the Ownership Interest to the other Members on the terms set out below:

(i.) Upon receipt of the terms of a third party offer to purchase such Membership Interest which is acceptable to the Selling Member (the "Third Party Offer") the Selling Member shall promptly deliver a copy of the Third Party Offer to all other Members, and shall thereafter promptly disclose all pertinent information with regard to the offer which the other Members may reasonably request. For the purpose of this Article, if the written offer contains provisions relating to the purchase and sale of items other than the Membership Interest, the Third Party Offer shall be deemed to relate to only those terms and conditions set out in the written offer which relate to the Membership Interest. The date that all of the Members receive notice of the Selling Member's intent to sell his Membership Interest is the "Notification Date".

(ii.) Each Member who is to receive the copy of the Third Party Offer made to the Selling Member will have twenty (20) days from the Notification Date in which to notify the Selling Member in writing of his intention to purchase all (but not less than all) of the Selling Member's Membership Interest for the amount and on the terms and conditions set out in the Third Party Offer. If more than one of the Members (the "Electing Members") elect to purchase the Selling Member's Membership Interest, each Electing Member shall purchase the part of the Selling Member's Membership Interest that is proportional to the Electing Member's Membership Interest divided by the aggregate Membership Interest of all Electing Members. If none of the Members elect to purchase the Membership Interest of the Selling Member within twenty (20) days from the Notification Date, the Selling Member may then sell his Membership Interest to the Third Party on the terms and conditions of the Third Party Offer.

(iii.) If one or more of the Electing Members elect to purchase the Membership Interest, then, accept as set out below, the Closing shall be on or before that date which is the later of: (i) thirty (30) days after the Notification Date, or (ii) the date set out for closing under the terms of the Third Party Offer, and the purchase price must be paid on the same terms and conditions as are set out in the Third Party Offer.

(iv.) At the Closing, the Selling Member will transfer the Membership Interest to be sold to the Electing Members, free and clear of any liens or encumbrances (other than any encumbrances to be taken subject to or assumed under the terms of the Third Party Offer). If the sale to the Third Party is not closed within 180 days following the Notification Date, the Membership Interest to be sold shall first be re-offered to the other Members as described in this Section.

(v.) A person who purchases a Membership Interest in the Company under this Section (other than an existing Member) shall only be entitled to the right of an Assignee until admitted to the Company as a Substitute Member as provided in this Agreement.

ARTICLE 17
COMPETITION

Neither this Agreement nor the relationship created hereby will preclude or limit, in any respect, the right of any Member or Manager or any Affiliate of any Member or Manager to engage, directly or indirectly, through participation, investment, or otherwise, in any opportunity or business of any type, including those that may be the same as or similar to the Company or its business, those that compete with the Company, and those in which the Company has invested. No Member, Manager, or any Affiliate of a Member or Manager will have any obligation to offer to the Company or any other Member the right to participate in any such activity. Neither the Company nor any other Member or Manager or any Affiliate of a Member or Manager will have any right, by virtue of this Agreement or the relationship created by this Agreement, with respect to any such activity.

Practice Comment: While the Limited Liability Company does not have imposed upon it the same duties of loyalty and care that relate to partnerships in Texas, the special relationship of the parties, in particular those that are the Managers of the Company may give rise to certain duties that are similar in common law to those that arise in for directors of corporations. If you represent the Managers, you may want to make clear the types of activities in which the Managers may engage without violating any such duty.
Practice Comment: There may be instances in which the parties desire to limit the ability of some or all of the Members to compete with the Company. It would be prudent to spell those limitations out in the Company agreement.
Practice Comment: Consider the buyout of the Ownership Interest of an employee upon termination of their employment..
Practice Comment: Consider the use of key man life insurance to fund a buy out arrangement and to potentially fix a price for the buy-out.

ARTICLE 18
DEFAULT BY MEMBER

18.1 ***Default of a Member***. Any one of the following events shall be deemed to be an Event of Default (the "Default") by a Member:

(i.) Failure to make a Capital Contribution in the manner or time periods set out herein.

(ii.) A material violation of any other provisions of this Agreement.

(iii.) The gross negligence, fraud, theft or willful misconduct committed by the Member against the Company or one or more of the Members in connection with the operation of the Company.

18.2 ***Terminations of Defaulting Member***. In the event of a default by a Member, the Member shall be provided written notification to cure such Default from the Company or any one or more Members who are not in default (the "Non-Defaulting Members"). The defaulting Member (the "Defaulting Member") shall have thirty (30) days following receipt of such notice to

cure said Default (the "Cure Period"). If the Defaulting Member fails to cure the Default within the Cure Period, the Company shall provide Notice to the Non-Defaulting Members (the "Default Notice") and the Non-Defaulting Members may pursue any and all remedies that may be available, at law and in equity, to cure such Default, including the remedy of specific performance if it is available.

Practice Comment: You may want to consider if notice and right to cure should be provided for a failure to make a Capital Contribution. You may also want to consider the time frame for a response to such a default.

Practice Comment: You may want to consider if remedies should be limited to only actual damages, or a forfeiture or discounted buy out.

Practice Comment: The TBOC provides a broad list of remedies for a failure to meet its obligations under the Agreement, including the failure to make a capital contribution, which is similar to the Texas Limited Liability Company Act. These include the right of forfeiture, as well as any other consequence. 101.153(b) TBOC

18.3 ***Right to Purchase Upon Default***. In addition to each of the remedies for a Default by a Member, as set out above, should a Default occur, each of the Non-Defaulting Members shall have the right to purchase all or a portion of the Defaulting Member's Membership Interest (the "Defaulting Interest") for _____ % of its Fair Value determined as of the date of such Default Notice. Such right may be exercised by any one or more of the Non-Defaulting Members giving, within forty five (45) days after such Default Notice, to the Defaulting Member notice of its desire to purchase all or a portion of such Defaulting Interest (for the purpose of this Section the "Notification Date"). If a Member provides a timely notice to purchase all or any portion of the Defaulting Interest, as soon as possible thereafter, the Company shall cause the Fair Value of the Defaulting Interest to be determined as of the date of such Default Notice. If there is more than one Non-Defaulting Members who desires to exercise such right (each, a "Purchasing Member"), the Defaulting Interest will be allocated among all Purchasing Members as follows: First, a portion of the Defaulting Interest will be allocated to each Non-Defaulting Member to the extent of the lesser of (i) the Non-Defaulting Member's pro rata portion (based on the number of Units owned by such Non-Defaulting relative to the number of Units of all Non-Defaulting Members) of the Defaulting Interest and (ii) the portion of the Defaulting Interest that such Non-Defaulting Member expressed a desire to purchase in such notice. If, after such allocation, any portion of the Defaulting Interest has not been allocated to the Non-Defaulting Members (the "Residual Defaulting Interest"), a similar allocation will be made of the Residual Defaulting Interest among the Non-Defaulting Members who have not been allocated the full portion of the Defaulting Interest that such Non-Defaulting Members expressed a desire to purchase in their respective notices. Such procedure will be continued until all of the Defaulting Interest has been fully allocated, if possible.

Practice Comment: This pro rata allocation is made on the basis of the number of Units they hold. It may be more appropriate to base it on the Sharing Ratios at the time of the purchase.

18.4 ***Closing***. If one or more Members elect to purchase the Defaulting Interest under the terms of this Article, the Closing shall be on or before that date which is the later of thirty (30) days after (i) the Notification Date or (ii) the determination of the Fair Value under the terms of this Agreement. At the Closing, the Defaulting Member will transfer the Membership Interest to be sold to the Non-Defaulting Members, free and clear of any liens or encumbrances (other than those which may have been created to secure any indebtedness or obligations of the

Company). At the Closing, the purchase price to be paid for the Defaulting Interest shall be paid to the Defaulting Member in cash.

18.5 ***Cumulative Remedies***. Except as otherwise expressly set forth in this Agreement, the rights and remedies provided by this Agreement are cumulative and the use of any one right or remedy by any party will not preclude or constitute a waiver of its right to use any or all other remedies. Such rights and remedies are given in addition to any other rights the Members may have by law, statute, ordinance, or otherwise.

18.6 ***Cure of Default***. The Default of any Member may be remedied by any one or more Non-Defaulting Members; provided however, to the extent such Default has occurred a remedy shall not terminate the rights of the Company or Non-Defaulting Members under this Article. In such event, any amount paid out to cure such Default, together with all reasonable expense and interest at the highest lawful rate not to exceed the Base Rate, shall be repaid to the Non-Defaulting Members by the Defaulting Member. Such advance with interest shall be repaid out of either (i) the distributions to the Defaulting Member pursuant to this Agreement, until the Non-Defaulting Member is fully reimbursed, or (ii) shall be paid out of the proceeds from the sale of the Defaulting Member's Membership Interest pursuant to this Article. Any cure of a Default under this Article shall have no effect on the other Member's rights to acquire a Defaulting Member's Membership Interest under the terms of this Agreement.

ARTICLE 19
WINDING UP

Practice Comment: TBOC clarifies the manner in which an entity is concluded. The procedures include a winding up and termination process. Winding up will begin with an event requiring a winding up, which may be voluntary or involuntary.

19.1 ***Event Requiring a Winding Up***. Except as set out below, upon the happening of the first to occur of the following events, the Company will begin to wind up its affairs;

(i.) the execution of an instrument approving the winding up of the Company by a Super Majority of the Members;

(ii.) the entry of a decree of judicial dissolution under Section 11.051(5) of the TBOC.

(iii.) the last remaining Member discontinues being a Member of the Company.

(iv.) the occurrence of a non-waivable event under the terms of the TBOC which requires the winding up of the Company.

No other event will require the winding up of the Company.

Practice Comment: Unless the certificate of formation or the Company Agreement specifies a fixed date as an

event requiring a winding up, the Company may continue in perpetuity. *See* §3.003 of the TBOC.

Practice Comment: §11.051(2) of the TBOC, which applies to all domestic entities and not just to limited liability companies, states that one event that requires a winding up is "a voluntary decision to wind up" the Company. However, it fails to specify who must make that voluntary decision. §11.058 of the TBOC, which relates only to limited liability companies, contains additional events that require a winding up. The written consent of all Members is one of those additional events. Therefore, it is unclear whether the voluntary decision referred to in §11.051(2) is the same as or different than a decision made by all Members.

Practice Comment: There may be other events that the parties want to trigger the winding up of the Company, including, for instance, a sale of all or substantially all of the assets of the Company. However, such a provision, if coupled with a vote of the Members to approve the sale, may create securities laws issues under Rule 145 promulgated under the Securities Act of 1933, as amended.

Practice Comment: If you represent the Managers, you may want the Managers to have the absolute right to cause the Company to begin winding up as well.

Practice Comment: If you represent a Member who is not a Manager, you may not want the Managers to have the absolute right to avoid a winding up of the affairs of the Company and may prefer, instead, to require the consent of the Managers and a Majority or Super Majority of the Members (or some other group of Members).

19.2 ***Revocation***. If an event of the type described in Section 19.1(a) occurs or any other voluntary act of the Members which require a winding up of the Company, the event may be revoked at any time prior to the termination of the Company by a determination of a Super Majority of the Members.

19.3 ***Cancellation***.

(i.) If an event of the type described in Section 19.1(c) occurs, the event may be cancelled, in writing, at any time within 1 year days after the occurrence of such event if (a) the personal representative of the last Member agrees in writing to (i) a continuation of the Company and (ii) the admission of the personal representative of the Member or its nominee or designee as a Member, or (b) a new Member is admitted to the Company by either the personal reprehensive of the last Member, the Mangers, or a Majority of the Assignees (in this case only, allowing the assignees of such Membership Interest to vote the Units of the Membership Interest they have been assigned).

(ii.) If an event of the type described in Section 19.1(d) occurs, the event may be cancelled, in writing, at any time within 1 year after the occurrence of such event if (a).

Note: If the Agreement provides an event for winding up, the event may be cancelled within one year unless the Agreement states otherwise. 11.152(c) TBOC.

Note: If the TBOC provides an event for winding up, the event may be cancelled within one year if the Code Section expressly allows for this and Agreement does not state otherwise. 11.152(c) TBOC.

Note: If a term is specified, the event requiring the winding up may be cancelled within three years 11.152(b) TBOC.

19.4 ***Interim Manager***. If an event requiring winding up occurs and there is no remaining Managers, a Majority of the Members may appoint an interim manager of the Company, who will have and may exercise only the rights, powers, and duties of the Managers necessary to preserve the Company assets, until new Managers, if any, are elected.

19.5 ***Effect of Event Requiring a Winding Up***. If an event requiring a winding up occurs and is not canceled or revoked, the Company will begin winding up its affairs and will continue until the assets have been distributed as set out below:

Practice Comment: As noted above, it is important to understand the difference between the occurrence of an event requiring a winding up and termination. The Company needs to continue in existence following the occurrence of an event requiring a winding up in order to complete the liquidation and winding up of the Company's affairs. If the Company continues only until the occurrence of an event requiring a winding up, the occurrence of the event and termination must, by definition, occur at the same time, which is not practical and creates a question as to what the terminated Company is during the winding-up phase.

ARTICLE 20
WINDING UP AND TERMINATION

20.1 ***Winding Up and Termination.*** As expeditiously as possible following the occurrence of an event requiring a winding up, the Managers will proceed to wind up the affairs of the Company, liquidate assets, pay liabilities, and make liquidating distributions to the Members, in the following order of priority:

(i.) the Managers shall cause an accounting to be made by a recognized firm of certified public accountants of the Company's assets, liabilities, and operations through the last day of the calendar month in which the event requiring winding up occurs;

(ii.) the Managers will use commercially reasonable efforts to maximize the value of the Company assets and then to sell Company assets. Any resulting Profits or Losses from each sale will be computed and allocated to the Capital Accounts of the Members in the manner described in Article 6;

(iii.) the Managers shall cause the notice described in article 11.052 of TBOC to be mailed to each known creditor of and claimant against the Company in the manner described in that Section.);

(iv.) the Managers will pay, to the extent there are funds available therefor, all of the Company's obligations and establish such reserves as the Managers deems prudent (the "Liquidation Reserve");

(v.) all remaining assets of the Company shall be distributed to the Members as follows:

(A) with respect to all Company property that has not been sold, the Fair Value of that property shall be determined and the Capital Accounts of the Members shall be adjusted to reflect the manner in which the unrealized income, gain, loss, and deduction inherent in property that has not been reflected in the Capital Accounts previously would be allocated among the Members if there were a taxable disposition of that property for the Fair Value of that property on the date of distribution; and

(B) Company property shall be distributed among the Members in accordance with the positive capital account balances of the Members, as determined after taking into account all capital account adjustments for the taxable year of the Company during which the liquidation of the partnership occurs; and those distributions shall be made by the end of the taxable year of the Company during which the liquidation of the Company occurs (or, if later, 90 days after the date of the liquidation).

(C) All distributions in kind to the Members shall be made subject to the liability of each distributee for costs, expenses, and liabilities theretofore incurred or for which the Company has committed prior to the date of termination and those costs, expenses, and liabilities shall be allocated to the distributee pursuant to this Article.

(D) all remaining cash and other Company property (other than the Liquidation Reserve) will be distributed among the Members as set out in Article 6.

(E) The distribution of cash and/or property to a Member in accordance with this Article constitutes a complete return to the Member of its Capital Contributions and a complete distribution to the Member of its Membership Interest.

20.2 Powers of Managers in Liquidation. Until final distribution, the Managers will continue to operate the Company properties with all of the power and authority of the Managers.

20.3 Cost of Liquidation. The costs of liquidation will be borne as a Company expense.

20.4 Termination; Release of Liquidation Reserve. At the time such distributions are made and the Liquidation Reserve established in accordance with subsection (a), the Company will terminate, but if at any time thereafter any of the funds in the Liquidation Reserve are released because, in the opinion of the Managers, the need for such reserve has ended, such funds will be distributed in accordance with subsection (a).

20.5 No Recourse. No Member will have any recourse against the Company or any other Member for the return of its Capital Contributions or any distributions not required by this Agreement except.

20.6 *Cancellation of Certificate*. On completion of the distribution of Company assets as provided herein, the Company is terminated, and the Managers (or such other Person or Persons as the TBOC may require or permit) will cause the cancellation of the Certificate and any other filings made by the Company and will take such other actions as may be necessary to terminate or reflect the termination of the Company.

Practice Comment: Remember that the Company does not terminate upon the occurrence of an event requiring a winding up.

ARTICLE 21
MISCELLANEOUS

21.1 ***Amendment or Modification***. Except to the extent this Agreement otherwise provides for a change to be effected without the approval required in this Section, this Agreement may be amended or modified at any time and from time to time only by a written instrument approved by the Managers and a Super Majority of the Members; *provided, however,* that (a) an amendment or modification (i) reducing a Member's share of profits, losses, distributions or Units (other than as a result of the issuance of additional Company Interests or adjustments to Sharing Ratios authorized without violation of this Agreement) or (ii) increasing the obligation of a Member to make Capital Contributions, requires the additional approval of the Member affected, (b) an amendment that disproportionately and adversely affects a Member requires the additional approval of the Member affected, (c) an amendment or modification reducing the required measure for any consent or vote in this Agreement requires the additional consent or vote of Members having their rights reduced, and (d) an amendment or modification made solely to reflect the admission or withdrawal of a Member need not be approved by any Member if the requirements set forth in this Agreement with respect to such admission or withdrawal are otherwise satisfied. In the event an amendment is properly adopted under the terms of this Agreement which require an amendment to the Certificate, the parties authorized to amend the Agreement are also authorized to amend the Certificate, as well.

Practice Comment: Absent express authorization to amend the Company agreement, a unanimous vote of Members is required, which is frequently difficult to obtain. *See* §101.053.of the TBOC.

Practice Comment: Some Company agreements give the Managers more authority to amend the Company agreement without the consent of the Members to comply, for instance, with the requirements of a lender or federal or state regulatory agency.

21.2 ***Notices***. All notices required or permitted to be given pursuant to this Agreement will be in writing and will be (i) personally delivered, (ii) mailed, first class postage prepaid, or delivered by a nationally recognized express courier service, charges prepaid, (iii) delivered by fax, or (iv) electronic message, if to the Company to the address of the Company's registered office (as reflected on the records of the Secretary of State of the State of Texas) or its email address of _____, or fax number _____and if to a Member, to the appropriate address set forth on Exhibit A to this Agreement, and if to a Manager, to the address shown on the records of the Company. Any such notice, when sent in accordance with the provisions of the preceding sentence, will be deemed to have been given and received (a) on the day personally delivered, (b) on the third day following the date mailed, (c) the date of actual delivery by a courier, and (d) the date of delivery and confirmation of delivery by the recipient if delivered by fax or electronic message. The Company or a Member may change its address, as set out above, by giving notice in writing to all other Members in the manner set forth in this Section, stating the new address.

Practice Comment: The requirement to use certified or registered mail, which is frequently seen in notice provisions, is often cumbersome and unnecessary. Consider whether notice by facsimile or electronic mail is appropriate. If so consider how the confirmation of delivery will be carried out. Some will state these methods may

only be used if followed by a delivery by hard copy.

Note: Section 6.053 of the TBOC also sets out new rules for when notice to a member is not required, including circumstance when prior notices have been returned, lost security holders under the Securities Exchange Act of 1934.

21.3 ***Failure to Pursue Remedies***. The failure of any party to seek redress for violation, or to insist upon the strict performance, of any provision of this Agreement will not prevent a subsequent act, which would have originally constituted a violation, from having the effect of an original violation.

21.4 ***Section Headings***. The headings in this Agreement are inserted for convenience and identification only and are in no way intended to describe, interpret, define, or limit the scope, extent, or intent of this Agreement or any provision hereof.

21.5 ***Severability of Provisions***. Every provision of this Agreement is intended to be severable. If any term or provision hereof is illegal or invalid for any reason whatsoever, such illegality or invalidity will not affect the validity of the remainder of this Agreement and the illegal or invalid provision will be enforced to the maximum extent possible to still be legal and valid.

21.6 ***Governing Law; Venue***. This Agreement, and the application or interpretation thereof, will be governed exclusively by its terms and by the laws of the State of Texas. Except for those actions, proceedings, or claims which this Agreement provides will be settled by arbitration, any action, proceeding, or claim arising out of or relating to this Agreement commenced by any Member in its individual capacity must be prosecuted in _____ County, Texas. Each Member waives any plea of privilege that might exist in the absence of such Member's agreement to prosecute such claim in _____ County, Texas, and each Member irrevocably submits to the non-exclusive jurisdiction of the state and federal courts of the State of Texas and consents to service of process upon such Member in any legal proceeding arising out of or in connection with this Agreement.

21.7 ***Counterparts***. This Agreement may be executed in any number of counterparts with the same effect as if the Members had all signed the same document. All counterparts will be construed together and will constitute one instrument. In making proof of this Agreement, it will not be necessary to account for more than one counterpart executed by the Person against whom enforcement is sought.

21.8 ***Successors and Assigns***. Each and every covenant, term, provision, and agreement herein contained will be binding upon each of the Members and their respective heirs, legal representatives, successors, and assigns and will inure to the benefit of each of the Members. Unless and until properly admitted as a Member, no assignee will have any rights of a Member beyond those provided by the TBOC to assignees or otherwise expressly provided herein to assignees.

Practice Comment: Note that this language differs from the boilerplate language concerning assignees in order to effect the concept that an assignee does not succeed to all of the *rights* of a Member until it is properly substituted. However, this language does *bind* an assignee so that, for instance, restrictions on transfers of Company interests are binding on transferees even if they are not admitted as Members.

21.9 ***Construction, Sections, Exhibits, Etc.*** Whenever the context requires, the gender of all words used in this Agreement includes the masculine, feminine, and neuter. Each reference to an "Exhibit" herein is, unless specifically indicated otherwise, a reference to an exhibit attached hereto, all of which are made a part hereof for all purposes, it being understood that if any Exhibit that is to be executed and delivered pursuant to the terms hereof contains blanks, it will be completed correctly and completely in accordance with the terms and provisions hereof and as contemplated herein prior to or at the time of its execution and delivery.

21.10 ***Further Assurances***. In connection with this Agreement and the transactions contemplated by it, each Member will execute and deliver any additional documents and instruments and perform any additional acts that may be necessary or appropriate to effectuate and perform the provisions of this Agreement and those transactions.

21.11 ***Waiver of Certain Rights***. Each Member irrevocably waives any right it may have to maintain any action for dissolution of the Company (other than pursuant to Section 19.1) or for partition of the property of the Company.

21.12 ***Attorneys' Fees***. If the Company or any Member brings any legal action to enforce or interpret the provisions of this Agreement, the prevailing party will be entitled to reasonable attorneys' fees, costs, and expenses, in addition to any other relief to which such party may be entitled.

21.13 ***Entire Agreement***. This Agreement sets forth the entire Agreement among the parties hereto with respect to the subject matter hereof and supersedes all prior agreements and understandings, if any, related thereto.

21.14 ***Third Party Beneficiaries***. Except for the Indemnified Persons, there are no third party beneficiaries of this Agreement.

Executed on the date or dates indicated below, to be effective as of the date first set forth above.

MANAGERS:

By: _____
Name (print): _____
Title: _____
Date: _____, 2004

MEMBERS:

[Signature line to be added for each Member]

EXHIBIT A

NAME, ADDRESS, AND UNITS OF MEMBERS

	Name	Address	Units
Members:	_____	_____	_____
		_____	
		_____	
	_____	_____	_____
		_____	
		_____	
	_____	_____	_____
		_____	
		_____	
	_____	_____	_____
		_____	
		_____	

[name, address, and number of Units to be added for each Member]

EXHIBIT B

Initial Capital Contributions

EXHIBIT C

Additional Capital Contributions

7. GOTCHA# 1.- Failure to Limit Negative Capital Account Makeup Obligations

Background

Partnerships are formed for the purpose of sharing the economic benefits and burdens of a business enterprise among partners. The TRPA, TRLPA and TBOC create capital accounts to track and allocate the economic attributes to be shared among the partners. The capital accounts of partners will generally be (i) increased by sums contributed by each partner to the partnership for its account and the profits allocable to the partner in accordance with the terms of the partnership agreement and (ii) decreased by sums distributed by the partnership to each partner and the losses allocable to the partner in accordance with the terms of the partnership agreement. (TBOC 151.001).

So, capital accounts exist as a sort of bank account inside of the partnership for each partner.

> By way of example, assume A, B and C were to create a new limited partnership in which (i) A, as general partner, contributes only a nominal sum; (ii) the limited partners, B and C, each contributes $50,000.00 as limited partners; (iii) profits and losses are split 1/3rd each; and (iv) the partnership borrows $900,000.00 to purchase a depreciable asset for $1,000,000.00. The asset is then sold for a loss for $900,000.00 and the losses are shared 1/3rd each. The capital accounts of B and C would each be $16,666.66 and the capital account of A would be ***negative*** $33,333.33.

What happens when a partner's account is overdrawn and it is time to terminate the partnership or that partner's interest in the partnership? Is there an obligation to restore the negative balance?

In the case of Park Cities Corp. vs. Byrd, 534 SW2d 668 (Tex. 1976), the courts concluded that, absent agreement to the contrary in the partnership agreement, this negative capital account is an asset of the partnership that can be recovered by the partnership.

While it is not expressly stated in the Park Cities case, these same principles would also apply to limited partners who generate a negative capital account unless the partnership agreement is clear that they have no obligation to make up this negative capital account.

TCOC 152.707 (d) provides the same.

If it is not the intention of the partners to cause a partner to be liable for this negative capital account, and you do not mention this in the partnership agreement, GOTCHA!

Actions to be Taken

Include in your agreement a provision that states that the partners will have no obligation to make up their negative capital accounts should one arise as of the time of a partner's withdrawal from the partnership or the termination of the partnership.

If you do include this type of provision in the partnership agreement you may also want to take care not to override the common law right of contribution among general partners.

For partnerships that elect registered limited liability limited partnership status, this provision may need to be modified to provide that a partner who creates a liability for the Partnership does have a duty to restore a negative capital account to the extent of such liability, at least to the extent the partner is not entitled to be indemnified by the Partnership for such liability.

WARNING!!!! The elimination of negative capital account responsibility may have drawbacks in the Federal income tax planning area. One of the cornerstones of the regulations under Section 704(b) of the Internal Revenue Code is that, generally speaking, a partner may not be allocated losses that will cause its capital account to become negative unless the partner has an obligation to make up that negative capital account (Note: There are some significant exceptions to this rule, which include exceptions relating to the allocation of loss generated from non-recourse debt). You should make certain to coordinate your drafting of the partnership agreement with the Federal tax planning issues. However, in doing so, keep in mind that one of the consequences your client may face if it elects to maximize the use of losses as a part of its tax planning benefits (by agreeing to make up a negative capital account in a partnership) will be an increase in the client's exposure to a real risk of loss if a negative capital account arises.

8. GOTCHA #2 - Failure to Properly Address The Manner in Which Phased-in Capital Is to be Contributed to a Partnership and Further Failure to Address Default Remedies

Background

The very first issue that a partner may be required to address in connection with the formation of a new partnership business is how much money (or other property) the partner will be required to contribute to the business, how much money (or other property) others will be required to contribute to the business, and when the capital will be required to be contributed.

While the need for additional capital may not be universal to all types of businesses, practitioners are often asked to draft partnership documentation for partnerships that will provide additional capital in stages, or in the event of a contingency.

When capital is to be contributed in stages, does the agreement address:

1. What conditions must arise before a partner can be required to contribute to the partnership?

2. When is the contribution to be made?

3. What remedies will the partnership and/or its partners have if the contribution is **not** made?

4. If the contribution is to be in the form of property, what will the condition of the property be, what will title be subject to, and what contracts will need to be assumed in connection with the acquisition of the property?

   If not -- **GOTCHA!**

Actions to be Taken

The partnership agreement should be drafted to address the timing and conditions for capital as well as the remedies for a failure to contribute. The following language sets out some of the alternatives that might be considered to address these issues.

Capital Contributions

Capital Contributions of the Partners. Each Partner does hereby agree to contribute to the Partnership that sum of capital that is set out beside the name of such Partner on Exhibit "A" attached hereto. The initial capital contributions to the Partnership by the [General Partner and Limited Partners - Partners] are as set out on Schedule "1" to Exhibit "A" (the "Initial Contribution").

*Additional Contributions. In addition to the sums contributed to the capital of the Partnership by a Partner as its Initial Contribution, as described above, each Partner does hereby unconditionally agree to contribute to the Partnership its allocable portion of additional capital as described on Exhibit "A" Schedule "2" attached hereto (the "Additional Contribution"). Such funds shall be required to be contributed to the Partnership for the purpose of providing funds to the Partnership to address its cash needs as may be determined by the General Partner [Managing Partner][**optional language**: and as described in the Approved Budget], and the General Partner [Managing Partner] shall call for such funds only to the extent necessary for these purposes or to address an unanticipated need for cash in the Partnership which, if not provided, would have the effect of causing material adverse effects to the operations of the Partnership. Each Partner shall contribute such Additional Contribution to the Partnership, in good funds payable to the Partnership, within ten (10) days following their receipt of written notice of a call for such Additional Contribution. In connection with the written notice for such Additional Contribution the General Partner shall provide a description of how such funds are to be used [**optional language**: under the terms of the Approved Budget] in connection with the business of the Partnership.*

No Partner shall be required to make additional capital contributions to the Partnership in excess of their Initial Contribution and their Additional Contribution.

*In the event a Partner fails to deliver a Capital Contribution to the Partnership for any reason within the time period described above (the "Defaulting Partner") the General Partner [any other Partner not in default of this Article] may notify the Defaulting Partner of the Default. If the Defaulting Partner fails to cure the Default within five (5) days of such notice (the "Cure Period"), the other [**Option "A"**: Partners] [**Option "B"**: Limited Partners] may elect to cause the Partnership Interests and all other ownership interests in the Partnership owned by the Defaulting Partner (the "Defaulting Partner's Interests") to be subject to purchase as described below. In such event, all other [**Option "A"**: Partners] [**Option "B"**: Limited Partners] shall have the right to purchase the Defaulting Partner's Interests in the Partnership at a purchase price equal to [**Option "A"**: fifty percent (50%) of its fair market value determined as of the date the Cure Period expired.] [**Option "B"**: fifty percent (50%) of the "Book Value" of the Defaulting Partner's Partnership Interests.] [Option "C", the capital account of the Defaulting Partner]. The [fair market value] [capital account] [Book Value] of the Defaulting Partner's Interests shall be computed in the same manner described in Article __, below. The [**Option "A"**: Partners] [**Option "B"**: Limited Partners] who desire to participate in the purchase of any or all of the Defaulting Partner's Interests (the "Electing Partner") shall make their election to acquire any or all of the Defaulting Partner's Interests within ten (10) days after the termination of the Cure Period (the "Determination Date"). In the event there is more than one [**Option "A"**: Partner] [**Option "B"**: Limited Partner] who is an Electing Partner(s), the right to purchase the Defaulting Partner's Interests shall be allocated among all Electing Partners in proportion to the relative Voting Interests; provided, however, in no event shall an Electing Partner be allocated more of the Defaulting Partner's Interest than such Electing Partner elected to purchase. If any [**Option "A"**: Partner] [**Option "B"**: Limited Partner] fails to give notice of its election on or before the Determination Date, then it shall be deemed to have elected not to participate in the purchase of the Defaulting Partner's Interests under the terms set forth above.*

In the event of a default under the terms of this Article, and in the event the Electing Partner(s) elect to purchase the Defaulting Partner's Interest in this Partnership in the manner described above, the Defaulting Partner shall execute or cause to be executed and delivered such instruments as may be necessary to transfer the Defaulting Partner's Interests to such Partners and to substitute the transferee Partner(s) as Partners in respect of the transferred Defaulting Partner's Interests.

The purchase of the Defaulting Partner's Interests will close within thirty (30) days after the Determination Date. At the Closing, the Defaulting Partner will convey to the Electing Partners all of the Defaulting Partner's Interests that are elected to be purchased, free and clear of any encumbrances (other than encumbrances created in the

ordinary course of the Partnership's business and permitted hereunder, and except as otherwise provided herein). The Purchase Price for the Defaulting Partner's Interests will be payable in the same manner as described in Article ___ for the buyout of a Defaulting Partner's Partnership Interest under the terms of that Article. Any payment to be made hereunder to a Defaulting Partner shall first be utilized to repay all monies owed by the Defaulting Partner to the Partnership or to any Partner.

Payment Structures

Payment. In the event the Partnership or the Non-Defaulting Partners purchase the Defaulting Partner's Interests, payment to the Defaulting Partner shall be paid in the following manner, as determined at the election of the Partnership, or Non-Defaulting Partner, as the case may be:

Alternative "A" - Payments over Time - Unsecured Note

Delivery to the Defaulting Partner of a promissory note to be paid in ten (10) consecutive annual payments sufficient to self-amortize the principal and interest of the note over a ten year period from the Closing, the first payment being 12 months after the date of Closing. The payment shall be evidenced by an unsecured promissory note made by the Partnership for the Electing Partners, as the case may be, payable to the order of the Defaulting Partner, with interest at a floating rate to be adjusted as of each payment date to the prime rate charged by CitiBank New York (or if CitiBank does not exist, a similar money center bank), but in no event greater than the highest rate allowed by applicable law. The note shall provide that upon default of any payment of principal or interest, the entire unpaid balance shall become due and payable immediately, and shall give the maker thereof the option of prepayment, in whole or in part, at any time without penalty. The note shall be upon the form provided by the Texas Bar Association and shall include no prepayment penalty. In addition, the note shall provide that it shall be (A) paid, in full, upon the sale of all or substantially all of the assets of the Partnership or, (B) in the event distributions are made in dissolution and termination of the Partnership, in connection with such dissolution and termination of the Partnership, distribution shall be made to the Defaulting Partner of non-cash assets of the Partnership with a fair market value (as computed under Section ____, above) equal to the sums due to the Defaulting Partner under the terms of the note in cancellation of the note.

Alternative "B" - Lump Sum Payment

In the event the Partnership or the Non-Defaulting Partners purchase the Defaulting Partner's Interest, payment to the Defaulting Partner of the purchase price for those Partnership Interests shall be paid in cash upon closing.

Additional Remedies for Failure to Contribute

Alternative "A" - Limited Remedies

The rights of the Electing Partners to acquire any or all of the Defaulting Partner's Interests pursuant to Article ___ below shall be the sole rights and/or remedies of the Partnership or any Partner to remedy a Defaulting Partner's failure to contribute to the Partnership under the terms of this Article ___, and the Defaulting Partner shall not be responsible to specifically perform its obligations or for actual and/or consequential damages for its failure.

Alternative "B" - Unlimited Remedies

The right of the Electing Partners to acquire any or all of the Defaulting Partner's Interests shall not be the sole right or remedy of the Partnership or the Partners to recover from the Defaulting Partner for its failure to make its capital contributions hereunder and the Partnership and/or any other Partner who is not a Defaulting Partner shall have all of those rights that may be afforded to such persons by law or equity to remedy such default including the right to recover for actual and consequential damages and the right to seek specific performance.

9. GOTCHA # 3 - Failure to Address the Post-Tax Nature of a Contribution and Pre-Tax Nature of a Distribution When Structuring Priority Returns

Background

Often, a limited partner who is contributing funds to a limited partnership will insist that its contribution receive some sort of priority return and, possibly, even earn some sort of a growth factor or interest factor on the outstanding balance of its capital account until such time the partner receives "its money back". When concerns of this nature are raised by a limited partner, the limited partnership agreement is often drafted to provide a disproportionate distribution to the limited partner until such time as a sum equal to its initial capital is returned. The Agreement provided by the General Partner may offer to provide a disproportionate distribution of cash in favor of the Limited Partners until they have recovered their capital contributed.

A limited partner may fail to focus on the fact that the money that they contributed to the Partnership is money on which they have already paid federal income tax; that is, "post-tax" monies, while some or all of the distribution they are receiving from the partnership may be pre-tax dollars; that is distributions which carry with them tax liabilities. Was it the intention of the limited partner for the preferred distribution to remain in place until the partner received the same amount of money pre tax or post-tax?

By way of example, if a limited partner is to contribute $1 million to a partnership, the $1 million may be contributed with money on which Federal income taxes have already been paid by the limited partner. If the limited partner is to receive a priority distribution until it gets "its money back", is the limited partner asking for $1 million after taxes or before? If it is the intention of the parties that the disproportionate allocation to that partner remain until the partner has received the sums the limited partner originally contributed to the partnership, the partner's tax liability relating to the distribution needs to be taken into consideration.

If its post tax, and this is not addressed by the partnership agreement

If not -- **GOTCHA!**

Actions to be Taken

In drafting the limited partnership agreement language should be included in the agreement that grosses up the distribution to make certain that it covers both the original contribution plus the Federal income tax (or other state tax) liabilities relating to the sums distributed. If a priority tax distribution has been included in the documentation, an easy way to address this issue may be to simply exclude the priority tax distribution from the calculation of those distributions that are counted toward the preferential return of capital.

10. **GOTCHA # 4- Failure to Address the Need for Cash to Pay Pass-Through Tax Liabilities** *"Nothing Is Certain in Life but Death and Taxes!"*

Background

Partnerships are, by their nature, pass-through entities for Federal income tax purposes; that is, all of the tax attributes of these entities pass through to their principals to be included directly in their Federal income tax returns. This occurs whether or not distributions are made from the partnership. On occasion, the operations of a partnership will establish a business plan that fails to address the fact that tax attributes, including income and gain, will be passed through to the partners, whether or not any distributions are actually made to the partners. The result is to create the potential for the allocation of taxable income or gain to the partners and creation of tax liability in connection therewith without a corresponding distribution of cash to address this tax liability.

This might happen by:

1. an agreement that distributes cash on a disproportionate basis to certain partners (possibly those who contributed capital) while profits are allocated on a proportionate basis – by way of example, profits are 50/50 but cash is distributed 90/10 until the limited partners receive all of their post tax capital contirbution; or

2. an agreement that causes cash to be used to create reserves or repay principal on indebtedness while income or gain is otherwise allocated to the partners [note this arises often in lot development deals with partial release requirements when the lenders partial release requirements provide for an aggressive repayments formula].

If these cash flow issues have not been properly addressed in the partnership agreement……GOTCHA!

Actions to be Taken

Include in the partnership agreement a first priority and required distribution to all partners in an amount necessary to address the tax liability created when partners are allocated income or gain in connection with the operation of the partnership. This allocation might be computed at the highest rate applicable to the income or gain based upon the character of such income or gain. In addition, in connection with the repayment terms of any indebtedness to be repaid by the partnership that requires large or disproportionate reductions in the principal of the indebtedness, provisions should be made with the lender to allow a portion of the partnership's revenues to be retained by the partnership and distributed to the partners for the purpose of providing for their pass-through tax liability.

A sample clause might read as follows:

> *Alternative provision for tax distributions. First, from and after such time as a Partner has received allocations of Profits from the Partnership which, in aggregate, exceed that Partner's aggregate allocation of Losses from the Partnership (the "Taxable Profits"), each such Partner shall receive a distribution of cash, within 90 days following the end of each calendar year in which Taxable Profits have been allocated to a Partner, equal to such Partner's allocation of such Taxable Profits for such calendar year, multiplied by a factor that is equal to the highest tax rate for Federal Income Tax purposes applicable for the tax year in which the allocation of Taxable Profits occurred, for the character of income that makes up such Taxable Profits allocation (the "Tax Distribution"). In the event a distribution is to be made under this paragraph that reflects only a portion of the sums to be distributed pursuant to this Article, the sums to be distributed shall be distributed to the Partners pro rata to the distributions to otherwise be made under this paragraph. In the event all or any portion of this distribution cannot be made, it shall be carried forward to be made as soon as distributable cash flow is available*.

GOTCHA # 5 - Failure to Allow Limited Partners to Participate in any Partnership Decision Making Due to a Misplaced (or Overstated) Fear That Any Involvement by Limited Partners Will Convert Them to General Partner Status

"Don't Cross a Black Cat's Path and Other Superstitions"

Background

There is a standard negotiation that takes place between the general partners and the limited partners in connection with the formation of a limited partnership where the limited partners attempt to limit the broad management powers desired by the general partner. Sometimes, the limited partners do this by requiring that they have just enough involvement to assure themselves that they will not be taken advantage of by the general partner. In other circumstances, the limited partners may desire the ability to oversee the actions of the general partner to a greater degree and, possibly, remove the general partner under defined circumstances. In still other circumstances, the limited partners may have a desire to be deeply involved in the decision making process of the partnership.

As a part of these negotiations, you will frequently encounter a ploy by those representing the general partner that suggests the level of activity requested by the limited partners will somehow convert the status of the limited partner to that of a general partner. Often, this fear causes the limited partners to back away from management controls that they might otherwise pursue.

If you represent a limited partner and accept this ploy **……GOTCHA!**

Actions to be Taken

Section 3.03 of the TRLPA and 153.102 and 153.103 of the TBOC provide that a limited partner **may** be liable to third parties if the limited partner participates in the control of the business of the partnership. However, these sections goes further and state:

> (A) If the limited partner does participate in the control of the business, the limited partner is only liable to persons who transact business with the limited partnership reasonably believing, based upon the limited partner's conduct, that the limited partner is a general partner; and
>
> (B) A limited partner does not participate in the control of the business of the partnership by acting in various capacities described in TRLPA which include:
>
> a. Consulting with or advising a general partner on any matter;
> b. Calling or participating in a meeting of the partners; or
> c. Voting on matters relating to the business of the partner.

With these powers available to the limited partners, it would seem that a well drafted limited partnership agreement can provide the limited partners with **substantial** management powers, certainly as great as a board of directors of a corporation.

However, in exercising these rights, the limited partners should take extra precautions when dealing with third parties. It is, of course, possible to step across a line that may cause confusion in the minds of third parties. While the agreement may be able to accomplish most, if not all, of the needs a limited partner may have to control a general partner, the limited partners should be well educated as to these limitations on their status.

11. GOTCH # 6 Failure to Cause Capital Accounts to Tract the Economics of the Deal

Background

The goal in entering into a partnership is to make and distribute profits AND on some level share the possibility of losses that might arise out of the operations of the business. The purpose of the partnership agreement therefore is to make certain that the documentation that defines the relationship of its principals is drafted in a manner that specifically accounts for this goal. Due to the flexibility of partnership documentation, which allows for disproportionate contributions, distributions, and allocations of profits and losses (which, after all, is one of the great benefits of these entities), the process of accounting for the economic relationship in one of these entities can become somewhat complex. In each case, it will require the entity documentation to track several different economic events for each partner. Typically these events consist of the following:

1. A partner's contribution to the partnership;
2. A partner's allocable portion of what it has earned in connection with the operations of the partnership;
3. A partner's allocable portion of losses allocated to the partner in connection with the operations of the partnership; and
4. The timing and priorities of distributions to partners of the entity.

This information is tracked for each partner for the life of the partnership through what is commonly referred to as the partner's "capital account".

When dealing with these capital accounts the problem practitioners often encounter is causing the partners right to get money from the partnership (distributions) to match the capital account accounting system.

If the distributions become out of sync with what is intended by the sharing of profits and losses as reflected in the capital account accounting system - **GOTCHA!**

Actions to be Taken

Practitioners often struggle to meet both the "economic desires" and "federal income tax requirement" for the allocation of profits and losses in entities which will be taxed as partnerships for Federal Income Tax purposes. At the moment, there are three prevailing philosophies which might be followed to achieve the intended results of the parties in defining this economic relationship.

The first is to try to draft the two schemes (the "economic desires" as set out in the contribution and distribution sections of this Agreement and the allocation of profits and losses for the purpose of addressing "federal income tax" requirement) to match.

The second is to define the "economic desires" as set out in the contribution and distribution sections of this Agreement and cause the allocation of profits and losses "fit" the contribution/distribution scheme.

A third structure is to make the Contributions and Distributions match the parties expectations, and have a Profit and Loss allocation that generally addresses the basis arrangement but does not match, in every case, the method by which Distributions and Contributions are shared, combined with a provision which allows the Managers to "adjust" the allocations of Profits and Losses on some equitable basis to cure any deficiencies between these two schemes.

The problem with the first philosophy is that it is difficult to achieve since there are so many different circumstances that can arise which affect Capital Accounts and Distributions schemes.

The second philosophy seems the most practical; however the formula is so complex it will challenge the patience of clients.

See example below of typical clause – which I have attempted to break down into concepts in the box which follows each paragraph

> *Profits and Losses for each Adjustment Period will be allocated among the Interest Owners so as to reduce, proportionately, in the case of Profits, the excess of their respective Target Capital Accounts over their respective Partially Adjusted Capital Accounts for such Adjustment Period and, in the case of Losses, the excess of their respective Partially Adjusted Capital Accounts over their respective Target Capital Accounts for such Adjustment Period. No portion of Profits or Losses for any Adjustment Period will be allocated to an Interest Owner, in the case of Profits, whose Partially Adjusted Capital Account is greater than or equal to its Target Capital Account or, in the case of Losses, whose Target Capital Account is greater than or equal to its Partially Adjusted Capital Account for such Adjustment Period.*
>
> *"Target Capital Account" means, with respect to any Interest Owner as of the close of business on the last day of any Adjustment Period, an amount (which may be either a positive or a deficit balance) equal to the amount such Interest Owner would receive as a distribution if all assets of the Company as of such date were sold for cash equal to the Gross Asset Value of such assets, all the Company liabilities were satisfied to the extent required by their terms, and the net proceeds were distributed pursuant to Section 4.1.*
>
> *"Partially Adjusted Capital Account" means, with respect to any Interest Owner as of the close of business on the last day of any Adjustment Period, the Capital Account of such Interest Owner as of the beginning of such Adjustment Period, after giving effect to all allocations of items of income, gain, loss, or deduction not included in Net Profit and Net Loss and all capital contributions and distributions during such period but before giving effect to any allocations of Net Profit or Net Loss for such period pursuant to this Section, increased by (i) such Interest Owner's share of Company Minimum Gain, as determined pursuant to Regulations Section 1.704-(2)(d), as of the end of such Adjustment Period and (ii) such Interest Owner's share of Partner Nonrecourse Debt Minimum Gain, as determined pursuant to Regulations Section 1.704-(2)(i), as of the end of such Adjustment Period.*

> *"Adjustment Period" means any period of time that begins on the effective date of the filing of the Certificate with the Secretary of State of the State of Texas (in the case of the first Adjustment Period) or the day following the end of the immediately preceding Adjustment Period (with respect to each subsequent Adjustment Period) and ends on the first to occur of: (a) the last day of a Fiscal Year, (b) the day immediately preceding the date of the "liquidation" of a Partner's interest in the Company (within the meaning of Section 1.704-1(b)(2)(ii)(g) of the Regulations), or (c) the date on which the Company is terminated pursuant to Section 12.1(d) following the occurrence of an event requiring a winding up."*

Many people opt for the third alternative out of frustration.

The practitioner should work closely with tax advisors to make certain that the distribution sections of the partnership agreement match or properly track the capital account provision of the partnership agreement.

12. GOTCHA # 7- Failure to Deal with Assignee Status of Transferees Where the Assignee Is Not Admitted as a Partner,

Background

Partnerships are an unusual relationship founded in both contract law and agency principles. The partnership agreement is itself a contract among its partners. However, in addition to the contractual relationship that is created, the partners are also considered to be agents of the partnership, providing to them special rights and obligations in agency law. Because of this "agency relationship," Sections 5.03 of the TRPA and 7.02 of TRLPA and TBOC 153.261-255 make a distinction between a person who is an assignee of a partnership interest and a person who is admitted as a partner to a partnership. Absent an agreement to the contrary, an assignee receives only the economic benefits of the assigned ownership interest but none of the management or agency rights related to the assigned ownership interest unless all of the partners otherwise consent. Often partnership agreements will fail to address this distinction and may fail to address transferability or assignability all together.

While no agency rights or management rights are afforded the assignee, the assignee is by statute provided some limited inspection rights to review the partnership books and records.

The Acts and the Code provide very specific rights to the assignees and assignors. If you fail to address these issues and the parties desire a result that is different that as set out in the Act or Code …….. **GOTCHA!**

Actions to be Taken

The agreement should be drafted to include provisions that address: (i) whether transferability should be allowed or not and, if allowed, the effect of a transfer, (ii) what rights may be assigned to an assignee, (iii) what obligations should be transferred and assumed by an assignee, and (iv) what steps must be taken for an assignee to become a substitute partner. This would seem to be

of particular interest to anyone who might take a security interest in a partnership interest. A sample provision that addresses assignees and the substitution of new partners might be as follows:

*a. Assignee of Interest in Partnership by Death or Divorce or Other Non-Approved Transfer. In the event a Partner should die, or by way of divorce all or a portion of its interest in the Partnership (Profits Interests or otherwise) should be awarded to the spouse of a Partner or the Partner shall transfer all or a portion of its interest in the Partnership (Profits, Interests or otherwise) in a manner in which the transferee is not admitted to the Partnership as a Partner, in no event shall the estate (or the beneficiaries of the estate) of the deceased Partner, the spouse of the divorced Partner or the transferee become a partner in this Partnership unless and until a majority [**Option:** "all of"] of the other Partners based upon their Voting Interests have approved such transfer and the transferee has complied with the terms of this Agreement which are required to become a substitute Partner.*

Unless and until any such transferee or assignee becomes a Partner of the Partnership in the manner herein prescribed, such transferee or assignee shall be entitled only to receive distributions of the Partnership to which the assigning Partner would otherwise be entitled and, for any proper purpose or as otherwise provided in the Act, to require reasonable information concerning the transactions of the Partnership and to make reasonable inspection of the Partnership books and records.

In the event that the Partners make additional contributions to the Partnership at any time while there is an outstanding interest in the profits of the Partnership held by a transferee or assignee who has not been admitted as a Partner to the Partnership, the Partner who assigned its interest in the Partnership (Profits Interests or otherwise) and such transferee or assignee shall be jointly and severally responsible and required to make a contribution to the Partnership in proportion to the ratio which the Profits Interests assigned to such transferee or assignee bears to all Profits Interests in the Partnership and such contribution shall otherwise be made in accordance with the other provisions of the Agreement governing contributions by Partners (if any). If the transferor Partner or such transferee or assignee does not make such contribution in accordance with the provisions of this Agreement (to the extent any such obligation may be created in the future by amendment to this Agreement), the transferor Partner and the transferee or assignee shall be treated as having breached this Agreement and the Partnership and/or its Partners shall have all of the rights that may be available at law or in equity to seek their remedies for such breach.

*b. Substitute Partner. In the event an assignment or transfer of all or a part of the Profits Interests and other interest in the Partnership held by a Partner should occur and the assignee is either a permitted transferee or a majority of [**Option:** "all of"] the other Partners agree to admit such transferee or assignee as a Partner in place of the transferor for the interest in the Partnership so transferred, no transferee or assignee shall have the right to become a Partner unless and until:*

(i) The transferee or assignee provides evidence of the transfer or assignment acceptable to the other Partners;

(ii) The transferee or assignee has executed an instrument reasonably satisfactory to the other Partners accepting and adopting the terms and provisions of this Agreement and agreeing to be bound by the terms and conditions hereof and expressly assuming the liability of the transferor; and

(iii) The transferee or assignee has paid or caused to be paid any reasonable expenses incurred in connection with the admission of the transferee or assignee as a Substitute Partner.

c. Liability of Transferor. In the event a transfer or assignment of an Ownership Interest is made in accordance with the terms of this Article or any other interest in the Partnership (the "Transferred Interest") and the transferee is substituted as a Partner in place of the transferor, the transferee who is substituted as a Partner shall become liable for all the terms, covenants, conditions and obligations relating to the Transferred Interest. In addition, the transferor, and its predecessors who have conveyed the Transferred Interest in the Partnership pursuant to this Article shall in no event be relieved of their liability, responsibility or obligations relating to such Transferred Interest, and such transferor and its transferee shall, at all times, remain jointly and severally liable for such liability, responsibility or obligations relating to such Transferred Interest.

13. GOTCHA # 8- Failure to Build Back Doors or Exit Plans for Partners

Background

All business relationships will, at some point in time, come to an end and, when they do, it is often beneficial to have considered in advance how the parties might separate their interests. Often it is best to have considered these issues before the parties have a reason to part company, since the process of parting company may be clouded by hostile emotions. A partner might be separated from a partnership or a partnership might separate from one of its partners through a number of different triggering events. Triggering events are as varied as the imagination of the participants. Common triggering events are:

1. Third party offers to purchase the Partnership assets or interests that triggers a right of first refusal;

2. A Right of first offer;

3. Exercise of a push-pull agreement; and

4. Death, Disability, Divorce or Default, provisions.

If clients create a relationship and never discuss the need or the options available for an exit, or back door -- **GOTCHA!**

Actions to be Taken

A partnership agreement should be drafted to include provisions that anticipate how the arrangement will be undone at the time the parties to the arrangement desire to part company. That is, the agreement should include a back door that allows a partner who is no longer in sync with the business philosophy of the others to part ways in a businesslike manner. Each such back door should make certain to set out:

A. The specifics of the triggering event;

B. The price of the buyout of the interest, and

C. A procedure for the partnership and/or other partners to take over the ownership interest of the departing partner.

The following are examples of a common form of right of first refusal, right of first offer, and push-pull agreement.

Right Of First Refusal

Third Party Offer. If a Partner (the "Selling Partner") receives a written offer (the "Third Party Offer") to purchase all or any purchase of his, her or its Ownership Interests in this Partnership from a person, and the Selling Partner elects to sell all of such Ownership Interests, the Selling Partner shall promptly deliver a copy of the Third Party Offer to all other Partners, and shall thereafter promptly disclose all pertinent information with regard to the offer which the other Partners may reasonably request.

Other Partners' Election. The date that all of the Partners receive notice of the Selling Partner's intent to sell his Ownership Interests is the "Notification Date." Each Partner who receives the copy of the Third Party Offer made to the Selling Partner will have forty-five (45) days from the Notification Date in which to notify the Selling Partner in writing of his intention to purchase all (but not less than all) of the Selling Partner's Ownership Interests for the amount and on the terms and conditions set out in the Third Party Offer. If more than one of the Partners (the "Electing Partners") elect to purchase the Selling Partner's Ownership Interests, each Electing Partner shall purchase the part of the Selling Partner's Ownership Interests that is proportional to the Electing Partner's Ownership Interests divided by the aggregate Ownership Interests of all Electing Partners.

Failure To Elect. If none of the Partners elect to purchase the Ownership Interests of the Selling Partner within forty-five (45) days from the Notification Date, the Selling Partner may then sell his Ownership Interests to the Third Party on the terms and conditions of the Third Party Offer.

Payment. If one or more of the Electing Partners elect to purchase the Ownership Interests, then the purchase price must be paid on the same terms and conditions as are set out in the Third Party Offer and the sale by the Selling Partner to the Electing Partner shall be closed on the date set out in Section _____.

Closing. If one or more Electing Partners elect to purchase the Ownership Interests of the Selling Partner, the Closing shall be on or before that date which is the later of: (i) seventy-five (75) days after all of the Notification Date, or (ii) the date set out for closing under the terms of the Third Party Offer. At the Closing, the Selling Partner will transfer the Ownership Interests to be sold to the Electing Partners, free and clear of any encumbrances (other than any encumbrances to be taken subject to or assumed under the terms of the Third Party Offer). If the sale to the Third Party is not closed within 180

days following the Notification Date the Ownership Interests to be sold shall first be reoffered to the other Partners as described in this Article.

Assignee Status. A person who purchases an Ownership Interests in the Partnership under this Article who is not yet a partner in the Partnership shall only be entitled to the right of an assignee under the Act until admitted to the Partnership as a Substituted Partner as provided in Section ____.

Right of First Offer

Proposed Offer. If a Partner (the "Selling Partner") desires to market all or a portion of his Ownership Interest (the "Proposed Sale Terms") to a third party the Selling Partner shall deliver to all other Partners a statement of intent to do so which shall contain the sales price and sale terms upon which he is willing to sell the Ownership Interest.

Other Partners' Election. The date that all of the Partners receive notice of the Selling Partner's intent to sell his Ownership Interests is the "Notification Date." Each Partner who receives the copy of the Proposed Sale Terms will have forty-five (45) days from the Notification Date in which to notify the Selling Partner in writing of his intention to purchase all (but not less than all) of such Ownership Interests for the amount and on the terms and conditions set out in the Proposed Sale Terms. If more than one of the Partners (the "Electing Partners") elect to purchase the Selling Partner's Ownership Interests, each Electing Partner shall purchase the part of the Selling Partner's Ownership Interests that is proportional to the Electing Partner's Ownership Interests divided by the aggregate Ownership Interests of all Electing Partners.

Failure To Elect. If none of the Partners elect to purchase the Ownership Interests of the Selling Partner within forty-five (45) days from the Notification Date, the Selling Partner may then sell his Ownership Interests to any third party provided (i) the sales price is no less than 90% of the purchase price offered to the Partners under the Proposed Sale Terms, and (ii) the sale occurs within no more than 270 days from the date the Proposed Sale Terms were offered to the other Partners.

Payment. If one or more of the Electing Partners elect to purchase the Ownership Interests, then the purchase price must be paid on the same terms and conditions as are set out in the Proposed Sale Terms and the sale by the Selling Partner to the Electing Partner shall be closed on the date set out in Section _____.

Closing. If one or more Electing Partners elect to purchase the Ownership Interests of the Selling Partner, the Closing shall be on or before that date which is sixty (60) days after all of the Notification Date. At the Closing, the Selling Partner will transfer the Ownership Interests to be sold to the Electing Partners, free and clear of any encumbrances (other than any encumbrances to be taken subject to or assumed under the terms of the Third Party Offer).

Assignee Status. A person who purchases an Ownership Interests in the Partnership under this Article who is not yet a partner in the Partnership shall only be entitled to the right of an assignee under the Act until admitted to the Partnership as a Substituted Partner as provided in Section ____.

Often we have seen the Push/Pull - Option/ Put used in connection with a limitation that it may only be used to break a "deadlock" situation. This has proved useful where deadlock can occur, however the parties will need to carefully consider how they define "deadlock" so that a mere disagreement over an issue will not trigger this rather draconian process.

Push/Pull Arrangement

Any Partner (the "Offering Partner") at any time may offer to purchase all, but not less than all of the ownership interest of any of the other Partners (the "Offeree Partners") at such price as is stated in a written notice (the "Offer") from the Offering Partner to the Offeree Partners. Any such Offer shall indicate a price the Offering Partner is willing to pay for each percentage point of Ownership Interest owned by the Offeree Partners (the "Per Unit Price"). Upon receipt of such Offer from the Offering Partner the Offeree Partners shall have 30 days (the "Election Period") from the date of receipt of the Offer within which to elect, by written notice to the Offering Partner (the "Notice of Election") either to sell their entire Ownership Interest to the Offering Partner at the price stated in the Offer or to participate in the purchase of the entire ownership interest of the Offering Partner at the per unit price set forth in the Offer. If an Offeree Partner (the "Electing Offeree Partner") elects to participate in the purchase of the entire Ownership Interest of the Offering Partner, said election shall act as an election to purchase that portion of the Offering Partners Ownership Interest that the Electing Offeree Partner's Ownership Interest bears to the aggregate of the Ownership Interests of each of Electing Offeree Partners (that is, if an Offeree Partner elects to participate in the purchase of the entire Ownership Interest of the Offering Partner, and said Offeree Partner must stand ready to purchase all of the Offering Partners Ownership Interest where it is the only Offeree Partner to elect, or (to some lesser pro rata portion of the Offering Partners Ownership Interest where more than one Offeree Partner elects to participate.) If an Offeree Partner elects to sell its entire Ownership Interest, said election shall constitute an election to (1) not participate in any joint purchase of all of the Offering Partners Ownership Interest, and (2) sell its entire Ownership Interest to the Offering Partner if, and only if, there are no Electing Offeree Partners to purchase the Offering Partner's entire Ownership Interest. If any Offeree Partner fails to give Notice of Election to the Offering Partner by the end of election period, the Offeree Partner shall be deemed to have elected to sell its entire Ownership Interest to the Offering Partner under the terms set forth in the Offer.

Any purchase and sale of an Ownership Interest purchased pursuant to this Article shall be at the purchase price stated in the Offer such price to be payable as provided therein.

The purchase of any Ownership Interest pursuant to this Article shall be closed within thirty days after the earlier of: (1) delivery of the Notice of Election, or (2) expiration of the Election Period. At the Closing the selling Partner or Partners will transfer their respective Ownership Interest to the purchasing Partner or Partners, free and clear any encumbrances (other than encumbrances incurred by the Partnership in the ordinary course of its business.)

A person who purchases an Ownership Interests in the Partnership under this Article who is not yet a partner in the Partnership shall only be entitled to the right of an assignee under the Act until admitted to the Partnership as a Substituted Partner as provided in Section ____.

14. GOTCHA # 9- Failure to Provide a Written Agreement

Background

The Act and the TBOC require both the Certificate of Formation (or Certificate of Limited Partnership) be filed with the Secretary of State's office **and** a partnership agreement to exist for a Partnership to be formed. TBOC 3.011. However, in each case the law explicitly permits oral partnership agreements. Section 1.02(10) of the TRLPA or 151.001 TBOC. If you file Certificate of Formation and a written agreement has not yet been entered into, can the parties argue that an oral partnership agreement exist, and the partnership has been formed prematurely?

If so ……GOTCHA!

To make this problem worse the Act and TBOC also provide that, certain provisions must be in writing to be effective. These include the parties desire to (i) modify the statutory definition of "Return of Capital" TRLPA Sections 1.02(13) or 153.208(b) TBOC, (ii) address the creation of groups or classes of limited partners 3.02(a) or 154.101 TBOC, (iii) address the admission of additional general partners 4.01 or 153,151 TBOC, (iv) override the effect certain actions of the general partner which will have the automatic effect of event of withdrawal from the partnership 4.02(a)(4) or 153.155 and (iv) address distributions, to the extent that distributions are not to be made on the basis of a return of capital stated in the partnership records and otherwise in accordance with the profits allocations set out in the partnership agreement, 5.04 or 153.208 TBOC.

Actions to Be Taken

Always make certain the partnership agreement is executed before filing the Certificate of Formation and include in the Agreement a provision that the partnership comes into existence on the later of the full execution of the agreement or the filing of the Certificate of Formation.

GOTCHA # 9 Distribution to a partner /Members

Background

Sec. 153.210 of the TBOC provides that a limited partnership may not make a distribution to a partner if, immediately after giving effect to the distribution and despite any compromise of a claim, all liabilities of the limited partnership, other than liabilities to partners with respect to their partnership interests and liabilities for which the recourse of creditors is limited to specified property of the limited partnership, exceed the fair value of the partnership assets.

Sec. 101.206 of the TBOC provides that a limited liability company may not make a distribution to a member if, immediately after giving effect to the distribution and despite any compromise of a claim, all liabilities of the company, other than liabilities to members with respect to their ownership interests and liabilities for which the recourse of creditors is limited to specified property of the company, exceed the fair value of the company's assets.

A member of a limited liability company who receives a distribution from the company in violation of Section 101.206 is not required to return the distribution to the company unless the member had knowledge of the violation. Similarly A limited partner who receives a distribution that is not permitted under Section 153.210 is not required to return the distribution unless the limited partner knew that the distribution violated the prohibition of Section 153.210.

If you make a premature distribution – **GOTCHA!**

Actions to Be Taken

Do not make distributions to partners when in this situation. Also, include a provision in the Agreement which requires re-contribute of a distributions to the extent the distribution is wrongful.