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JOINT VENTURE FORMATION

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I. INTRODUCTION

The joint venture is a vehicle for the development of a business opportunity by two or more entities acting together,[1] and will exist if the parties have: (1) a community of interest in the venture, (2) an agreement to share profits; (3) an agreement to share losses, and (4) a mutual right of control or management of the venture.[2] A joint venture may be structured as a corporation, partnership, limited liability company (**"*LLC*"**), trust, contractual arrangement, or any combination of such entities and arrangements.[3] Structure decisions for a particular joint venture will be driven by the venturers' tax situation, accounting goals, business objectives and financial needs, as well as the venturers' planned capital and other contributions to the venture, and antitrust and other regulatory considerations.[4] Irrespective of the structure chosen, however, certain elements must be considered in connection with structuring every joint venture.

Because a joint venture is commonly thought of as a limited duration general partnership formed for a specific business activity, the owners of a joint venture are sometimes referred to herein as *"partners"* or *"venturers,"* and the joint venture as the *"entity," "partnership"* or *"venture,"* in each case irrespective of the particular form of entity or other structure selected for the joint venture.

II. JOINT VENTURE FORMATION

A. Choice of Entity

A joint venture may take the form of:

(1) <u>Contractual Relationship Not Constituting an Entity Recognized by Statute</u>. The joint venturers may operate under a relationship such as a contractual revenue-sharing joint venture, a lease, a creditor/debtor relationship or some other relationship not constituting an entity. A risk to this structure is that a court will impose general partnership duties or liabilities on the venturers if their relationship is found to constitute "an association of two or more persons to operate a business as co-owners for a profit" (the traditional definition of a partnership) regardless of how the venturers characterize and document their relationship.[5] In determining whether the relationship is a partnership, the following factors are considered:

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[1] *See* James R. Bridges and Leslie E. Sherman, *Structuring Joint Ventures*, 4 INSIGHTS 17 (Oct. 1990); David Ernst and Stephen I. Glover, *Combining Legal and Business Practices to Create Successful Strategic Alliances*, 11 INSIGHTS 6 (Oct. 1997); Stephen I. Glover, *Joint Ventures and Opportunity Doctrine Problems*, 9 INSIGHTS 9 (Nov. 1995); Warren S. de Wied, *Structuring Strategic Equity Investments*, 1 No. 8 M&A Law. 7 (Jan. 1998).

[2] Pitts & Collard, L.L.P. v. Schechter, No. 01-08-00969-CV, 2011 WL 6938515, at *11 (Tex. App.—Hous. [1st Dist.] Dec. 29, 2011). For additional discussion of whether the agreement is, in fact, a joint venture, see *id.* at *11-12.

[3] *See* JOINT VENTURE TASK FORCE OF NEGOTIATED ACQUISITIONS COMMITTEE, MODEL JOINT VENTURE AGREEMENT WITH COMMENTARY (Am. Bar Ass'n., 2006).

[4] *See* Byron F. Egan, *Business Entities in Texas after 2011 TexasLegislature*, TexasBarCLE program on Legislative Changes Affecting Business Entities, July 13, 2011, *available at* http://images.jw.com/com/publications/1629.pdf ("Business Entities Paper")

[5] In *Derrick Resources, Inc. v. David Wilstein, et al*, 312 S.W.3d 864,877 (Tex. App.– Houston [1st Dist.] 2009, no pet.), which involved an oil and gas drilling and production arrangement pursuant to a contract that was called a "joint venture agreement," the Court in an opinion by Justice Evelyn Keyes held that the joint venture agreement created a fiduciary relationship that imposed a fiduciary duty of full and fair disclosure on the managing venturer as it held title to the venture's properties in its name and had a power of attorney to dispose of the properties, and explained:

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- Receipt or right to receive a share of profits;
- Expression of an intent to be partners;
- Participation or right to participate in control of the business;
- Sharing or agreeing to share losses or liabilities; or
- Contributing or agreeing to contribute money or property to the business.[6]

A contract is sometimes used to establish the relationship among the venturers even though one of the entities referenced below may be the operating vehicle for the joint venture.

(2) General Partnership. A general partnership is an unincorporated association of two or more persons to operate a business as co-owners for profit that is not formed under another statute.[7] The definition of a partnership under Texas general partnership statutes includes a "joint venture" or any other named association that satisfies the definition of "partnership."[8] A joint venture may be legally nothing more than a limited purpose general partnership, although a joint venture may be organized as a corporation, limited partnership or LLC.[9] A general partnership may become a limited liability partnership (***"LLP"***), which is a general partnership in which the partners are not vicariously liable to third parties for some or all partnership obligations if it makes the requisite filings with the appropriate state secretary of state and complies with certain other state statutory requirements.[10]

(3) Limited Partnership. A limited partnership is a partnership having at least two partners including at least one limited partner and at least one general partner, and that files a

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Joint venturers for the development of a particular oil and gas lease have fiduciary duties to each other arising from the relationship of joint ownership of the mineral rights of the lease. [citation omitted] Likewise, if there is a joint venture between the operating owner of an interest in oil and gas well drilling operations and the non-operating interest owners, the operating owner owes a fiduciary duty to the non-operating interest owners. [citation omitted] In addition, "[a]n appointment of an attorney-in-fact creates an agency relationship," and an agency creates a fiduciary relationship as a matter of law. [citation omitted] The scope of the fiduciary duties raised by a joint venture relationship, however, does not extend beyond the development of the particular lease and activities related to that development.

The dispute revolved around the manager's sale of parts of its interest after giving oral notice to the other venturer, but not the written notice accompanied by full disclosure specified in the agreement. The opinion is lengthy and very fact specific, but the following lessons can be drawn from it: (i) calling a relationship a joint venture can result in a court categorizing the relationship as fiduciary, which in turn implicates duties of candor and loyalty and could implicate the common law corporate opportunity doctrine, (ii) it is important to document the relationship intended (an LLC could be used as the joint venture entity and the LLC company agreement could define or in Delaware eliminate fiduciary duties), and (iii) written agreements should be understood and followed literally.

[6] *See* Brown v. Keel, No. 01-10-00936-CV, 2012 WL 760933, at *4 (Tex. App.—Hous. [1st Dist.] March 8, 2012) (citing Ingram v. Deere, 288 S.W. 3d 886, 896 (Tex. 2009)); Westside Wrecker Serv., Inc. v. Skafi, ___ S.W. 3d ____, 2011 WL 5617748, at *9 (Tex. App.—Hous. [1st Dist.] Nov. 17, 2011); Hoss v. Alardin, 338 S.W.3d 635, 641-42 (Tex. App.—Dallas 2011). *See also* Business Entities Paper, *supra* note 4, at *76.

[7] Egan, *supra* note 4, at 78.

[8] TEX. BUS. ORGS. CODE ANN. § 152.051(b) (Vernon 2011).

[9] *See* Alan R. Bromberg and Larry E. Ribstein, *Bromberg & Ribstein on Partnership*, § 2.06 (Aspen Publishers 2010).

[10] Egan, *supra* note 4, at 147-162.

certificate of limited partnership with the applicable state secretary of state.[11] A limited partnership can be structured in some states as a limited liability limited partnership (***"LLLP"***), which is a limited partnership in which general partners are not vicariously liable to third parties for some or all partnership obligations.[12]

(4) Limited Liability Company. A limited liability company (***"LLC"***) is an unincorporated organization formed by one or more persons filing a certificate of formation or articles of organization under a state limited liability company act.[13] None of the members of an LLC are personally liable to a third party for the obligations of the LLC solely by reason of being a member.[14]

(5) Corporation. A corporation is a business organization usually formed under a state corporation law, but occasionally is formed under federal law such as certain banking organizations.[15]

There are several factors typically considered in determining the appropriate form of entity or other structure for a joint venture. Key elements usually are:

•How the entity and the venturers will be taxed under federal and state law;[16] and

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[11] *Id.* at 88-105.

[12] *Id.* at 164.

[13] *Id.* at 106-147.

[14] *Id.* at 106.

[15] *Id.* at 52-75.

[16] Federal and state taxation of an entity and its owners for entity income is a major factor in the selection of the form of entity for a particular situation. Under the United States (*"U.S."*) Internal Revenue Code of 1986, as amended (the *"IRC"*), and the *"Check-the-Box Regulations"* promulgated by the Internal Revenue Service (*"IRS"*) (Treasury Regulations §§ 301.7701-1, -2 and -3), an unincorporated business entity may be classified as an "association" taxable as a corporation subject to income taxes at the corporate level ranging from 15% to 35% of taxable net income, which is in addition to any taxation which may be imposed on the owner as a result of distributions from the business entity. Alternatively, the entity may be classified as a partnership, a non-taxable "flow-through" entity in which taxation is imposed only at the ownership level. Although a corporation is classified only as a corporation for IRC purposes, an LLC or partnership may elect whether to be classified as a partnership. A single-owner LLC is disregarded as a separate entity for federal income tax purposes unless it elects otherwise. *See* Byron F. Egan, *Business Entities in Texas after 2011 Texas Legislature*, Texas Bar CLE webcast on Legislative Changes Affecting Business Entities, Texas Bar CLE Webcast, July 13, 2011, at 15-19, *available at* http://images.jw.com/com/publications/1629.pdf.

In addition to federal tax laws, an entity and its advisors must comply with federal anti-money laundering and terrorist regulations. An entity and its advisors are charged with reviewing and complying with the Specially Designated Nationals List (*"SDN List"*) maintained by the Office of Foreign Assets Control (*"OFAC"*) within the U.S. Department of Treasury. U.S. citizens and companies (subject to certain exclusions typically conditioned upon the issuance of a special license) are precluded from engaging in business with any individual or entity listed on the SDN List. The SND List and OFAC guidance are available on the OFAC website at http://www.ustreas.gov/offices/enforcement/ofac/.

Texas does not have a state personal income tax. The Texas Legislature has replaced the Texas franchise tax on corporations and LLCs with a novel business entity tax called the *"Margin Tax,"* which is imposed on all business entities other than general partnerships wholly owned by individuals and certain "passive entities." Essentially, the calculation of the Margin Tax is based on a taxable entity's, or unitary group's, gross receipts after deductions for either (x) compensation or (y) cost of goods sold, provided that the "tax base" for the Margin Tax may not exceed 70% of the entity's total revenues. This "tax base" is apportioned to Texas by multiplying the tax base by a fraction of which the numerator is Texas gross receipts and the denominator is aggregate gross receipts. The tax rate applied to

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- Who will be liable for its contract, tort and statutory obligations (the entity itself will always be liable to the extent of its assets; the question is whether owners will be liable if entity's assets are insufficient to satisfy all claims).

Although these two considerations tend to receive the principal focus in the entity choice decision, other factors can be critical: (a) the application of non-tax laws and regulations to the venture and the venturers, (b) the ability of the venturers to order their duties and rights by agreement (e.g. limitation of fiduciary duties), (c) the venturers' exit strategies, (d) the manner in which the venturers will share the economic benefits of the venture, (e) the possible need for additional contributions by new and existing venturers, (f) the manner in which the venturers will make day-to-day and policy decisions of the venture, (g) the agency rules applicable to the venture and (h) particular requirements of the venture's business.

Increasingly, the LLC is the form of entity chosen for domestic joint ventures in the U.S.[17] The allure of the LLC is its unique ability to bring together in a single business organization the best features of all other business forms. Owners of a properly structured LLC can obtain both a corporate-styled liability shield and the pass-through tax benefits of a partnership. All equity holders of an LLC have the limited liability of corporate shareholders even if they participate in the business of the LLC. Under the Check-the-Box Regulations, a domestic LLC with two or more members typically would be treated for federal income tax purposes as a partnership.[18] An LLC is subject to Texas Margin Tax.

An underlying premise of the Texas and Delaware LLC statutes is that 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.[19] Most of the provisions relating to the organization and management of an LLC and the terms governing its equity interests are contained in the LLC's company agreement, which will typically contain provisions similar to those in limited partnership agreements and corporate bylaws,[20] and may also constitute the joint venture agreement for a joint venture organized as an LLC.[21]

The identity of the specific entities through which the venturers will participate in the venture is another key initial decision. If the joint venture is structured as a partnership, special purpose subsidiaries will typically be used in order to insulate the venturers from liabilities incurred by the venture. A venturer may desire to use a special purpose subsidiary to facilitate a subsequent transfer of all or a portion of its interest in the venture. The use of special purpose subsidiaries may lead to requests for parent company guarantees of subsidiary obligations to other venturers and to the entity.

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the Texas portion of the tax base is 1% for all taxpayers, except a narrowly defined group of retail and wholesale businesses that will pay a ½ of 1% rate. For calendar year taxpayers, the Margin Tax is payable annually on May 15 of each year based on entity income for the year ending the preceding December 31.

[17] Rodney D. Chrisman, *LLCs are the New King of the Hill: An Empirical Study of the Number of New LLCs, Corporations, and LPs Formed in the United States between 2004-2007 and How LLCs Were Taxed for Tax Years 2002-2006*, XV FORDHAM J. CORP. & FIN. L. 459 (2010), *available at* http://www.abanet.org/dch/committee.cfm?com=CL590000.

[18] Egan, *supra* note 4, at 2

[19] *Id.* at 114-117.

[20] TEX. BUS. ORGS. CODE ANN.§ 101.052 (Vernon 2010); Joint Task Force of the Committee on LLCs, Partnerships and Unincorporated Entities and the Committee on Taxation, ABA Section of Business Law, *Model Real Estate Development Operating Agreement with Commentary*, 63 BUS. LAW. 385 (2008).

[21] *See* JOINT VENTURE TASK FORCE OF NEGOTIATED ACQUISITIONS COMMITTEE, *supra* note 2, at 38.

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In addition to the form of entity or arrangement, the organizers need to choose the particular state laws that are to govern the entity. States like Delaware and Texas, which have well-developed statutes and case law relating to the relationship between owners of the joint venture and managers of the entity, are preferable to states where the law is not as well recognized. The state of organization also may affect where evidences of lien rights ("financing statements") need to be filed under Article 9 of the Uniform Commercial Code in secured lending arrangements, and where bankruptcy proceedings may be commenced.

B. Scope and Purpose

A central element of every joint venture is the scope of its business, both as to the types of products, services or technology which the venture is organized to provide, and as to the geographic area or markets in which they will be provided.[22] Where the business of the venture is similar to the existing business of one or more of the venturers, it may be necessary to contractually define the activities that may be conducted by the venturers only through the venture and those which the parties may conduct separately.[23]

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[22] *Id.* at xv-xviii.The ABA Model Joint Venture Agreement was prepared based on an assumed fact pattern in which the proposed joint venture is a Delaware LLC with two members, one of whom has a 60% equity interest (*"Large Member"*) and one of which has a 40% equity interest (*"Small Member"*), and both of which are engaged in manufacturing and selling high tech equipment. They want to contribute their assets relating to existing products to the joint venture on its formation, and collaborate through the joint venture in developing and marketing the next generation of high tech equipment, which they know will have be smaller and more efficient. Although they are competitors, neither has a significant market share in their common products. Independently they will continue to manufacture and distribute other products. Based on this fact pattern, the ABA Model Joint Venture Agreement sets forth in recitals at the front definitions of the "Business" of the proposed joint venture and other terms that will be used throughout the Agreement to define the purposes of the joint venture, which in turn will be used to restrict other activities of the venturers elsewhere in the Agreement, as follows:

A. Large Member, through its High Tech Division, and Small Member are each currently engaged in the research, development, manufacturing and distribution of __________________ products ("Initial Products"), that each will manufacture on a toll basis for the joint venture and that will be distributed by the joint venture.

B. Large Member, through its High Tech Division, currently distributes its Initial Products in the United States and elsewhere in the world, and Small Member currently distributes its Initial Products in the United States.

C. Large Member and Small Member desire to form a joint venture as a Delaware limited liability company (the "Company") for the distribution of Initial Products and for the research, development, manufacture and distribution of ______________ products that are not Initial Products ("New Products;" and with such activities as to the Initial Products and the New Products being the "Business").

[23] *Id.* at 182-86. Article 15 of the ABA Model Joint Venture Agreement prohibits a member from competing with the joint venture during the period it holds an interest therein, and for a specified period thereafter, as follows:

Article 15: Competition

15.1 Competition.

(a) *Generally*. Each Member will not, and will take all actions necessary to ensure that its Affiliates will not, engage in the activities prohibited by this Section 15.1. For purposes of this Section 15.1, the ''Restricted Period'' for a Member lasts for so long as it or any of its Affiliates owns any interest in the Company. In addition, in the case of a Member whose Member Interest is purchased pursuant to Article 10 (Buy-Sell in the Absence of Default) or pursuant to Article 11 (Buy-Sell Upon Default), the Restricted Period lasts until the last day of the 60th full calendar month following the date on which the purchase is closed. Further, in the case of a Member that does not continue the Company's Business following the dissolution of the Company in which the Company's Business is continued by the other Member or by a third party purchaser, the Restricted Period lasts until the last day of the 60th full calendar month following the date on which the Company is wound up.

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A related issue is the extent of the exclusivity of the joint venture. What happens if the joint venture does not have the funds to pursue particular prospects, projects or opportunities within its scope? Further, where the joint venture has its own managers, what will happen if the managers decide not to pursue a particular project or market? Alternatives for dealing with these issues include: (i) make exclusivity absolute (e.g., even though the joint venture cannot or does not pursue a specific opportunity falling within its "scope," all participants are barred from doing so); (ii) allow each participant separately to pursue opportunities which are within the "scope" of the joint venture and which the joint venture management decides not to pursue; or (iii) where one or more participants, but not the required number of participants, vote for the venture to fund and pursue a particular opportunity, only those participants which

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(b) *Restricted Activities*. Neither the Member nor any of its Affiliates will:

(i) *Non-Competition*: during the Restricted Period, carry on or be engaged, concerned or interested directly or indirectly whether as shareholder, partner, director, employee, member, agent or otherwise in carrying on any business similar to or competing with the Business anywhere in the United States (other than as a holder of not more than five percent of the issued voting securities of any company listed on The Nasdaq Stock Market or any registered national securities exchange);

(ii) *Non-Solicitation of Customers*: during the Restricted Period, either on its own account or in conjunction with or on behalf of any other Person, solicit or entice away or attempt to solicit or entice away from the Company as a customer for the products or services of the Business any Person who is, or at any time within the prior 24 months has been, a customer, client or identified prospective customer or client of the Company;

(iii) *Non-Solicitation of Employees*: during the Restricted Period, either on its own account or in conjunction with or on behalf of any other Person, employ, solicit or entice away or attempt to employ, solicit or entice away from the Company, any Person who is or will have been at the date of or within 24 months before any solicitation, enticement or attempt, an officer, Manager, consultant or employee of the Company or of the other Member, whether or not that Person would commit a breach of contract by reason of leaving employment; *provided, however,* that the foregoing does not restrict a Member from employing a Manager or officer who was an employee of that Member while serving as a Manager or as an officer of the Company nor does it restrict a Member's general advertisements with respect to a position that are not directed to officers, Managers, consultants or employees of the Company, and *provided, further,* that the Members may agree from time to time that this Section does not apply to specified persons; and

(iv) *Restriction on Use of Trademark and Trade name*: at any time hereafter in relation to any trade, business or company use a name including the word [or symbol] [''__________''] or any similar word [or symbol] in a way as to be capable of or likely to be confused with the name of the Company.

15.2 Distribution. The Company may enter into distribution agreements with independent distributors who currently are distributing products manufactured by a Member. A Member whose products are distributed by an independent distributor after the Closing will not be considered to have breached its obligations under Section 15.1 by virtue of those distribution arrangements. Each Member hereby waives any claim it may have under existing distribution agreements with independent distributors that an independent distributor would have breached of its non-competition obligations under that existing distribution agreement by distributing Products under a distribution agreement with the Company.

15.3 Independent Agreements. The agreements set forth in this Article 15 (and in each Section or other part of this Article 15) are, will be deemed, and will be construed as separate and independent agreements. If any agreement or any part of the agreements is held invalid, void or unenforceable by any court of competent jurisdiction, then such invalidity, voidness or unenforceability will in no way render invalid, void or unenforceable any other part of the agreements; and this Article 15 will in that case be construed as if the void, invalid or unenforceable provisions were omitted.

15.4 Scope of Restrictions. While the restrictions contained in this Article are considered by the Members to be reasonable in all the circumstances, it is recognized that restrictions of the nature in question may not be enforced as written by a court. Accordingly, if any of those restrictions are determined to be void as going beyond what is reasonable in all the circumstances for the protection of the interest of the Members, but would be valid if restrictive periods were reduced or if the range of activities or area dealt with were reduced in scope, then the periods, activities or area will apply with the modifications as are necessary to make them enforceable.

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voted in favor of pursuing the opportunity may pursue it if the venture does not. Where the parent company or any affiliates of a participant have the ability to compete with the joint venture, it may be necessary to get the agreement of such companies, or the covenant of the participant to cause such companies, not to compete with the joint venture.

Because common law "business opportunity" doctrines may impose fiduciary duties on the partners to offer business opportunities to the venture,[24] joint venture agreements typically define carefully the scope of the contemplated business of the venture and the extent to which partners may compete with the venture or pursue opportunities that the venture might undertake. Often these matters are dealt with in a separate business opportunity agreement.

C. Funding

Mechanisms should be established for funding the joint venture's activities – both for initial funding and for additional funding during the life of the joint venture. The joint venture's governing documents should state the participants' rights and obligations to make mandatory and optional cash contributions, as well as mandatory and optional loans to the joint venture entity.[25]

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[24] *See* Byron F. Egan, *How Recent Fiduciary Duty Cases Affect Advice to Directors and Officers of Delaware and Texas Corporations*, University of Texas School of Law 34th Annual Conference on Securities Regulation and Business Law, Dallas, TX, February 10, 2012, at 78-82, *available at* http://images.jw.com/com/publications/1712.pdf; *see also* Byron F. Egan, *Good Faith, Fair Dealing and Other Contractual and Fiduciary Issues*, University of Texas School of Law 2009 Partnerships and LLCs Conference, Austin, TX, July 23, 2009, at 68-70, 78-85 and 102-11, *available at* http://images.jw.com/com/publications/1220.pdf; Kevin G. Abrams and Srinivas M. Raju, *Recent Developments in the Corporate Opportunity Doctrine Under Delaware Law*, 10 INSIGHTS 2 (1996).

[25] JOINT VENTURE TASK FORCE OF NEGOTIATED ACQUISITIONS COMMITTEE, *supra* note 2, at 59-64. Article 3 of the ABA Model Joint Venture Agreement provides for initial and additional capital contributions, as well as loans, by the venturers as follows:

Article 3: Capital Contributions

3.1 Initial Capital Contributions. Immediately after the completion of the capital contributions for which Section 2.8 (Closing Deliveries) provides, the parties agree that the Book Capital Account of each Member is as follows:

<u>NameInitial Book Capital Account</u>

Large Member $

Small Member $

3.2 Additional Capital Contributions and Member Loans.

(a) *Mandatory Only If Included in Business Plan*. Each Member will make additional capital contributions (''Additional Capital Contributions'') or loans (''Member Loans'') to the Company in accordance with its Member Interest, but only in the amounts and at the times set forth in the Business Plan as it may be amended from time to time. Neither Member is otherwise required to contribute capital or make Member Loans to the Company.

(b) *Procedure*.

(i) *Generally*. All requirements or requests for Additional Capital Contributions or Member Loans will: (A) be in a notice delivered to each Member by the CEO stating that the Additional Capital Contribution has been approved by the Management Committee in accordance with Section 5.4 (Actions Requiring Management Committee Approval—Major); (B) state the aggregate amount of Additional Capital Contributions or Member Loans and the amount of each Member's share of such Additional Capital Contribution or Member Loan; and (C) specify the date that the Additional Capital Contribution or Member Loan is to be made, which will not be sooner than twenty Business Days following the Member's receipt of the notice.

(ii) *Accompanying Certificate*. The Members will deliver certificates to the Company and to each other, dated as of the date the Additional Capital Contribution or Member Loan is to be made, that contain reasonable representa-

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tions and warranties as to such matters as is appropriate (for example, to establish the ability of the Member to comply with its obligations under the Business Plan). In addition, if Additional Capital Contributions are to consist of property other than cash, such certificate will contain reasonable representations and warranties as to the ownership and condition of any such property.

(c) *The Member Loans*. Each Member Loan will be evidenced by a promissory note bearing interest at a fluctuating rate equal to six percentage points over the Prime Rate, but not in excess of any legally permitted rate of interest (the ''Specified Interest Rate''). ''Prime Rate'' means the prime rate as published in the ''Money Rates'' table of *THE WALL STREET JOURNAL* on the first publication day of the calendar quarter in which the loan was made and as adjusted as of the first publication day of each subsequent calendar quarter until paid. Each Member Loan will (i) be for such term and subject to such security, if any, as determined by the Management Committee, (ii) if necessary to secure financing for the Company, be subordinated to any other indebtedness of the Company or a portion of it, (iii) become due and payable in the event the Company is dissolved, (iv) rank pari passu with any and all other Member Loans and (v) be nonrecourse as to the other Member.

3.3 Failure of a Member to Make a Required Additional Capital Contribution or Make a Required Member Loan. If a Member (the ''Non-Contributing Member'') fails to make a required Additional Capital Contribution or make a required Member Loan when due, the other Member (the ''Other Member'') may exercise one or more of the following remedies (but shall not be entitled to any other remedy either in the name of the Other Member or in the name of the Company).

(a) *Proceeding to Compel*. Institute a proceeding either in the Other Member's own name or on behalf of the Company to compel the Non-Contributing Member to contribute the Additional Capital Contribution or Member Loan.

(b) *Loan by Other Member*. Loan to the Company on behalf of the Non-Contributing Member the amount of the Additional Capital Contribution or Member Loan due from the Non-Contributing Member (''Shortfall Loan''), in which case the Non-Contributing Member: (i) will be liable to the Other Member for the amount of such Shortfall Loan, plus all expenses incurred by the Other Member (not including any interest incurred by the Other Member in borrowing the funds used to fund the Shortfall Loan) and the Company in connection with such Shortfall Loan, including reasonable attorneys' fees, and interest at the Specified Interest Rate; and (ii) hereby grants the Other Member a lien on its Member Interest to secure repayment of the Shortfall Loan and constitutes the Other Member as its attorney in fact to file a financing statement on form UCC-1 to perfect such lien; *provided, however,* that the rights under such lien may be exercised by the Other Member only in connection with exercising its rights to purchase such Member's Member Interest in accordance with Section 8.2(a) (Material Default). The Non-Contributing Member will deliver to the Other Member the certificate representing its Member Interest as security for such lien. Any distributions otherwise due from the Company to the Non-Contributing Member will be applied as described in Section 4.4 (Payment of Distributions if Shortfall Loans Outstanding). The Non-Contributing Member will repay the Shortfall Loan in 20 equal quarterly installments plus interest at the Specified Interest Rate. The Non-Contributing Member's failure to make any such payment when due is a Material Default under Section 8.2(a).

(c) *Other Borrowings*. Borrow on behalf of the Company from a lender other than the Other Member the amount of the Additional Capital Contribution or Member Loan due from the Non-Contributing Member on such terms as the Other Member, in its sole discretion, may be able to obtain. In this case, the Non-Contributing Member will be liable to the Company for the principal amount of, and interest on, such borrowing, plus all expenses reasonably incurred by the Company in connection with such borrowing, including reasonable attorneys' fees (also a ''Shortfall Loan''). The Non-Contributing Member's failure to make any such payment when due is a Material Default under Section 8.2(a) (Material Default). The Non-Contributing Member does hereby grant to the Company a lien on its Member Interest to secure repayment of the Shortfall Loan and constitutes the Other Member as its attorney in fact to file a financing statement on form UCC-1 to perfect such lien. The Non-Contributing Member will deliver to the Company the certificate representing its Member Interest as security for such lien. Any distributions otherwise due from the Company to the Non-Contributing Member will be applied as described in Section 4.4 (Payment of Distributions if Shortfall Loans Outstanding).

(d) *Refuse to Make Capital Contribution*. Refuse to make any Additional Capital Contributions or Member Loans to the Company without being in default of any provision of this Agreement.

(e) *Exercise of Article 8 Rights*. Exercise its rights under Article 8 (Dis-solution and Other Rights upon De-

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Typically, procedures will be put in place whereby the participants, either directly or through their representatives on the joint venture's board of directors or board of managers, agree upon an annual budget for the venture.[26] Cash required from the participants to fund the venture's operations under the agreed budget is then frequently provided on the call of the venture's senior manager, based on an agreed schedule. An issue related to the cash funding of the joint venture is the contribution of services, technology, products, or other assets to the joint venture. To the extent that a participant will be making any such non-cash contributions, a procedure should be established at the outset of the venture for the valuation of such contributions.

D. Allocations and Distributions

Subject to various limitations imposed by tax laws, the participants have great flexibility in structuring the allocation and distribution of profits, losses, and other items.[27] For ex-

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fault).

3.4 No Withdrawal of or Payment of Interest on Capital. No Member will have any right to withdraw or make a demand for withdrawal of all or any portion of its Book Capital Account. No interest or additional share of profits will be paid or credited to the Members on their Book Capital Accounts.

[26] *Id.* at 86-9. Section 5.8 of the ABA Model Joint Venture Agreement provides for business plans and budgets of the joint venture as follows:

5.8 Business Plan.

(a) *Initial Business Plan*. The initial business plan (''Business Plan'') attached as Exhibit One covers the first five years of the Company's proposed operations and identifies the items that (i) the Members deem to be critical to the Company's success (a ''Critical Target'') and (ii) if not met, will give one or both Members the rights described in Section 7.2(a) (Fundamental Failure). The Business Plan will include a budget prepared in accordance with Section 5.8(b). The Members intend that the Business Plan be reviewed or modified, as applicable, at least annually. At least 120 days before the beginning of each Fiscal Year, the CEO will deliver to the Management Committee any proposed modifications in the Business Plan.

(b) *Budget Contents*. The budget will include:

(i) a projected income statement, balance sheet and operational and capital expenditure budgets for the forthcoming Fiscal Year;

(ii) a projected cash flow statement showing in reasonable detail: (A) the projected receipts, disbursements and distributions; (B) the amounts of any corresponding projected cash deficiencies or surpluses; and (C) the amounts and due dates of all projected calls for Additional Capital Contributions for the forthcoming Fiscal Year; and

(iii) such other items requested by the Management Committee.

(c) *Consideration of Proposed Plans*. Each proposal to continue or modify a Business Plan will be considered for approval by the Management Committee at least 90 days before the beginning of the Fiscal Year to which it pertains. The Management Committee may revise the proposed Business Plan or direct the CEO to submit revisions to the Management Committee.

(d) *Continuation of Existing Business Plan*. Until a revised Business Plan is approved, the Company will be managed consistently with the last Business Plan approved by the Management Committee, adjusted as necessary to reflect the Company's contractual obligations and other changes that result from the passage of time or the occurrence of events beyond the control of the Company.

[27] *Id.* at 64-9. Article 4 of the ABA Model Joint Venture Agreement provides for the allocation of profits and losses and distributions as follows:

Article 4: Allocation of Profits and Losses; Distributions

4.1 Shares of Profits and Losses. Each Member will share in the Company's profits and losses in accordance with its Member Interest. A Member's share of the taxable income or loss or other tax items of the Company will be determined in accordance with Attachment 12 (Tax Provisions).

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4.2 Definitions.

(a) *Cash Flow from Operations*. ''Cash Flow from Operations'' means all cash available to the Company from its Ordinary Course of Business activities remaining after payment of current expenses, liabilities, debts or obligations of the Company (other than principal or interest on Member Loans).

(b) *Other Available Cash*. ''Other Available Cash'' means cash generated by the Company's activities outside its Ordinary Course of Business activities.

(c) *Tax Amount*. The ''Tax Amount'' is the product of (i) the Effective Tax Rate and (ii) the Company's Cumulative Net Taxable Income. The Tax Amount will not be in excess of the product of (A) the Effective Tax Rate and (B) the Company's taxable income for the Fiscal Year of the determination. For purposes of the foregoing:

(i) *Effective Tax Rate*. The ''Effective Tax Rate'' is the highest U.S. corporate income tax rate for that year plus the federal tax-effected state and local income tax rate in effect at the principal office of the Company.

(ii) *Cumulative Net Taxable Income*. The ''Cumulative Net Taxable Income'' is determined at the end of the Company's Fiscal Year with respect to which the Tax Amount is to be determined and is the sum of all taxable income for the current and all prior Fiscal Years reduced by the sum of all taxable losses for the current and all prior Fiscal Years.

4.3 Distributions. Distributions are made in the following priority:

(a) *Distribution of Tax Amount*. At least ten Business Days before each date when a U.S. corporate estimated income tax payment is due, the Company will distribute, from Cash Flow from Operations (or, if necessary, from Other Available Cash), to each Member its share of the Tax Amount estimated by the Company to have accrued during the estimated tax period before the distribution date. No later than 65 days after the end of the Company's Fiscal Year, the Company will distribute, from Cash Flow from Operations (or, if necessary, from Other Available Cash), to each Member its share of any previously unpaid Tax Amount for such Fiscal Year.

(b) *Reserves*. The Management Committee will establish reserves from Cash Flow from Operations for:

(i) contingent or unforeseen obligations, debts or liabilities of the Company, as the Management Committee deems reasonably necessary;

(ii) amounts required by any Contracts of the Company; and

(iii) such other purposes as decided upon by the Management Committee.

(c) *Pay Member Loans*. Member Loans will be paid from Cash Flow from Operations (or, if necessary, from Other Available Cash) as follows:

(i) If the terms of Member Loans state the order of priority of payment of principal and interest, then those priority rules will apply.

(ii) Otherwise, the Company: (A) first will pay interest due on the Member Loans, on a proportionate basis without preference, in accordance with the total amount of interest outstanding on all Member Loans; and (B) then will pay the principal due on the Member Loans, on a proportionate basis without preference, in accordance with the total amount of principal outstanding on all Member Loans.

(d) *The Balance*. Subject to Section 4.4, the Company will distribute the balance, if any, of Cash Flow from Operations to the Members in accordance with their Member Interests within 90 days after the end of the Company's Fiscal Year.

(e) *Other Available Cash*. Distributions of Other Available Cash are to be made in such amounts and at such times as determined by the Management Committee, taking into account the needs of the Company and the distribution policy set forth in Section 4.8. If there is not enough Cash Flow from Operations to make all the distributions provided for in Sections 4.3(a) and 4.3(c), Other Available Cash will be used to make the distributions in the priority specified in such Sections.

4.4 Payment of Distributions if Shortfall Loans Outstanding. If a Shortfall Loan is outstanding, any distribution made pursuant to Section 4.3 to which the Non-Contributing Member otherwise would be entitled will be considered a distribution to the Non-Contributing Member. The distribution, however, will be paid directly to the Other Member if the other Member has made a Shortfall Loan. Such distribution will be applied first against interest and then against principal, until all accrued interest and principal of Shortfall Loans are repaid in full. The distribution then will be applied against expenses, in the same manner as provided in Section 3.3(c) (Other Borrowings). If there are two or more Shortfall Loans outstanding to the Non-Contributing Member, any distribution paid pursuant to this Sec-

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ample, where the joint venture entity in partnership form is expected to have substantial operating losses in its early years, the partners may allocate a disproportionate share of the losses to participants who have income against which to offset such losses, while allocating a disproportionate share of any other benefits or net income in future years to the other participants. The provisions of a venture's governing documents are typically structured in such a manner as to maximize all available financial benefits, whether they be in the form of income, gains, losses, deductions, tax credits, or other items.

E. Governance and Management

The venture's governing documents (whether in the form of a shareholders agreement, partnership or LLC agreement or otherwise) usually specify the mechanics of the overall governance and the day-to-day management of the venture's affairs.[28] Typically, this will in-

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tion will be applied to such Shortfall Loans on a first-in, first-out basis. If the Company has borrowed money under Section 3.3(c) (Other Borrowings), the Non-Contributing Member's distribution will be used to pay principal and interest on such loans.

4.5 No Priority. Except as otherwise provided in this Agreement, no Member will have priority over any other Member as to the return of capital, allocation of income or losses, or any distribution.

4.6 Other Distribution Rules. No Member will have the right to demand and receive property other than cash in payment for its share of any distribution. Distribution of non-cash property may be made with the consent of both Members. The preceding sentence expressly overrides the contrary provisions of DLLCA § 18–605 as to non-cash distributions.

4.7 Liquidating Distribution Provisions. Subject to Section 4.4 (Payment of Distributions of Shortfall Loans Outstanding), distributions made upon liquidation of any Member Interest will be made in accordance with the positive Book Capital Account balance of the Member. These balances will be determined after taking into account all Book Capital Account adjustments for the Company's Fiscal Year during which the liquidation occurs.

4.8 Distribution Policy. The Members recognize the need for the Company to fund its own growth. Accordingly, funds of the Company will be retained for this purpose, and no distribution under Sections 4.3(d) (Balance) or 4.3(e) (Other Available Cash) will be paid to the Members, until and so long as the Company's Cash Flow from Operations net of reserves established pursuant to Section 4.3(b) (Reserves) exceeds the level required to be self-sustaining, without the need for further investment by the Members.

4.9 Limitation upon Distributions. No distribution will be made to Members if prohibited by DLLCA § 18–607 or other Applicable Law.

[28] *Id.* at 71-83. Sections 5.1 – 5.5 of the ABA Model Joint Venture Agreement provide for the governance of the LLC as follows:

5.1 Management Committee.

(a) *Managers*. The business and affairs of the Company will be managed exclusively by or under the direction of a committee (the ''Management Committee'') consisting of four individuals (each a ''Manager''). Except for the right to appoint a delegate in Section 5.2(f) (Delegation) and for the delegation of authority to Officers provided in Section 5.7 (Other Officers and Employees), no Manager may delegate his rights and powers to manage and control the business and affairs of the Company. The foregoing expressly override the contrary provisions of DLLCA § 18–407.

(b) *Initial Appointment; Replacement*. Each Member will appoint two Managers, unless otherwise provided by Section 8.3(c) (Management Changes). The initial appointments by each Member are as follows:

<u>Large MemberSmall Member</u>

By written notice to the other Member and Managers, a Member may in its sole discretion remove and replace with or without cause either or both of its appointed Managers with other individuals. A Manager may be an officer or employee of a Member or of an Affiliate of a Member. Each Manager will serve on the Management Committee until his successor is appointed or until his earlier death, resignation or removal.

(c) *Compensation and Expenses of Managers*. Each Member will pay the compensation and expenses of the

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Managers it appoints.

(d) *Right to Rely on Manager Certificate*. Any Person dealing with the Company may rely (without duty of further inquiry) upon a certificate signed by any Manager as to (i) the identity of any Manager or Member, (ii) the existence or nonexistence of any fact or facts that constitute a condition precedent to acts by the Management Committee or that are in any other manner germane to the affairs of the Company, (iii) the Persons who are authorized to execute and deliver any instrument or document of the Company, or (iv) any act or failure to act by the Company or any other matter whatsoever involving the Company, any Manager or any Member.

(e) *Signing on Behalf of the Company*.

(i) *Generally*. Except as otherwise provided in Section 5.1(e)(ii) or as required by law but without limiting Section 5.6(c)(v) (CEO-Authority), the signature of any Manager (or other individual to whom the Management Committee has delegated appropriate authority) is sufficient to constitute execution of a document on behalf of the Company. A copy or extract of this Agreement may be shown to the relevant parties in order to confirm such authority.

(ii) *Deeds, Certain Promissory Notes, etc*. The signature of the Chair of the Management Committee is required (A) to convey title to real property owned by the Company or (B) to execute (1) promissory notes with respect to indebtedness for borrowed money in excess of $________ and related trust deeds, mortgages and other security instruments and (2) any other document the subject matter of which exceeds $_______ or that binds the Company for a period exceeding one year.

(f) *No Authority of Members to Act on Behalf of the Company*. Except as otherwise specifically provided in this Agreement, no Member will act for, deal on behalf of, or bind the Company in any way other than through its representatives (acting as such) on the Management Committee.

5.2 Management Committee Meetings.

(a) *Meetings*. The Management Committee will hold regular meetings (at least quarterly) at such time and place as it determines. Any Manager or the Chair may call a special meeting of the Management Committee by giving the notice specified in Section 5.2(g).

(b) *Chair*. The chairperson of the Management Committee (''Chair'') will be one of the two Managers who are appointed by Large Member. The initial Chair is____________. The Chair will preside at all meetings of the Management Committee.

(c) *Participation*. Managers may participate in a meeting of the Management Committee by conference video or telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other. Such participation will constitute presence in person at the meeting.

(d) *Written Consent*. Any action required or permitted to be taken at any meeting of the Management Committee may be taken without a meeting upon the written consent of the number and identity of Managers otherwise required to approve such matter at a Management Committee meeting. Each Manager will be given a copy of the written consent promptly after the last required signature is obtained. A copy of the consent will be filed with the minutes of Management Committee meetings.

(e) *Minutes*. The Management Committee will keep written minutes of all of its meetings. Copies of the minutes will be provided to each Manager.

(f) *Delegation*. Each Manager has the right to appoint, by written notice to the other Managers, any individual as his delegate. That delegate may attend meetings of the Management Committee on his behalf and exercise all of such Manager's authority for all purposes until the appointment is revoked.

(g) *Notice*. Written notice of each special meeting of the Management Committee will be given to each Manager at least five Business Days before the meeting and will identify the items of business to be conducted at the meeting. No business other than those items listed in the notice may be conducted at the special meeting, unless otherwise expressly agreed by all the Managers. The notice provisions of this Section may be waived in writing and will be waived by a Manager's attendance at the meeting, unless the Manager at the beginning of the meeting or promptly upon his arrival objects to holding the meeting or transacting business at the meeting and does not thereafter vote for or assent to action taken at the meeting.

5.3 Voting of Managers; Quorum.

(a) *Generally*. Each Manager will have one vote, subject to Section 5.3(b). Except as otherwise provided in Section 5.4, all actions by the Management Committee will require the approval of a majority of the Managers present at a meeting at which a quorum exists.

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volve a board of directors or managers of the joint venture entity on which each of the participants may have representation more or less proportional to its percentage interest in the joint

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(b) *Chair's Additional Vote*. If (i) Large Member is not a Defaulting Member (see Section 8.2) and (ii) there is a tie vote of the Managers on an action other than those described in Section 5.4, then the Chair will have an additional vote on such action.

(c) *Quorum*. Three Managers will constitute a quorum for the transaction of business, unless (i) a duly called meeting is adjourned because (A) neither of the Managers appointed by a Member attends that meeting and (B) neither of the Managers appointed by that Member attends a meeting duly called as to the same items of business of the adjourned meeting within thirty days after the adjournment of that first meeting and (ii) notice of both meetings complied with Section 5.2(g). In such event, two Members will constitute a quorum for the transaction of business.

5.4 Actions Requiring Management Committee Approval—Major.

The following actions require the approval of both (1) a majority of the Managers present at a meeting at which a quorum exists and otherwise in accordance with Section 5.3 and (2) at least one Manager appointed by each Member:

(a) amendment of this Agreement;

(b) admission of additional Members;

(c) approval of any new Business Plan or material modification of an existing Business Plan (for this purpose, any change by 10% or more during any Fiscal Year of any line item in the budget that is included in the Business Plan, any change in a Critical Target and any Additional Capital Contribution will be considered material);

(d) merger or combination of the Company with or into another Person;

(e) sale or other disposition of all or substantially all of the Company's assets;

(f) any material change in the Business, in particular, entering into the manufacture and/or sale of a new line of products or adopting a new line of business or a new business location;

(g) any material change in accounting or tax policies of the Company;

(h) conversion of the Company to another form of legal entity;

(i) entering into or amending the terms of any transaction or series of transactions between the Company and any Member, any Affiliate of a Member, or any Manager or Affiliate of a Manager; and

(j) amendment of any Related Agreement.

5.5 Actions Requiring Management Committee Approval—Other. The following actions require the approval of (1) a majority of the Managers present at a meeting at which a quorum exists and otherwise in accordance with Section 5.3 (Voting of Managers; Quorum) **but** (2) not the separate approval of at least one Manager appointed by each Member:

(a) any change in the Company's auditors (if the new auditor will be an independent, nationally recognized accounting firm);

(b) any change by less than 10% during any Fiscal Year of any line item in the budget that is included in the Business Plan or any other change in the Business Plan that does not require approval under Section 5.4(c);

(c) any establishment of reserves under Section 4.3(b) (Reserves) and other applicable provisions of this Agreement;

(d) the incurring of indebtedness for borrowed money in excess of $_____;

(e) the entering into of contracts, or series of related contracts, obligating the Company in excess of $_____;

(f) the acquisition or disposition of any interest in any other business or the participation in any increase or reduction of capital of any other business that is within the budget and consistent with the Business Plan;

(g) the purchase of real estate or other fixed assets or the sale and disposition of real estate or other fixed assets at a price of or valued at more than $_____;

(h) the lending or advancing of any monies, including the guaranteeing or indemnifying of any indebtedness, liability or obligation of any Person other than the granting of trade credit and other than in the Ordinary Course of Business as established in the then-current budget; and

(i) the creation of, the permitting to exist for more than 15 days of, or the assumption of any Encumbrance upon Company assets that have an aggregate value in excess of 10% of the aggregate value of the Company's total assets; *provided, however,* that the renewal of existing Encumbrances is not included in this limitation.

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venture. Sometimes, provision is made for an independent member of the board, appointed by the agreement of the participants, in order to protect against board deadlock over operational issues.[29]

Additionally, it is common to provide that certain key decisions may be made only with the unanimous, or a supermajority, approval of the board or the members. Such key decisions often include the following matters (often with materiality parameters): (1) capital expenditures in excess of specified amounts; (2) incurring indebtedness; (3) initiating or settling litigation; (4) entering into contracts involving more than an agreed sum; or (5) entering into contracts with a joint venture participant or any of its affiliates.

The venture's governing documents typically specify the types of officers and other managers who will conduct the day-to-day operations of the venture. Provision is also typically made for the removal and replacement, compensation and other benefits, and indemnification of board members, officers and other managers.

F. Restrictions on Transfer of Joint Venture Interests

Joint ventures are entered into between a limited number of parties (typically two) who respect each other and believe the others can contribute substance and funding to the venture over an extended period. As a result, provision is typically made to restrict the participants' transfer of their joint venture interests and for the admission and withdrawal of participants to the joint venture. Typically, a participant's ability to transfer its interest is restricted to transfers to wholly-owned subsidiaries (and perhaps other affiliates) and then only so long as the transfer causes no adverse tax consequences to the joint venture or any of the other participants. A transfer of an interest to a third party can make the other parties wish to dissolve the venture or at least have the right to approve their new partner, and ordinarily are more restricted. Sometimes such transfers are entirely prohibited, although such a provision may make it necessary for the participants to have the right to unwind the venture unilaterally. Alternatively, transfers to third parties may be permitted only where the other participants have a right of first refusal to buy the interest to be transferred. A right of first refusal may apply either from the inception of the venture or after a specified number of years during which no third-party transfers are permitted. To facilitate the right of first refusal mechanism, it may be helpful to require third-party transfers to be solely for cash consideration and separate and apart from transfers of other property. The ability to make transfers to third parties is also frequently limited by the establishment of specific objective criteria which a party must satisfy in order to qualify as an acceptable transferee. These criteria might include a required minimum net worth for a transferee, a requirement that the transferee not be a competitor of the non-transferring venturer, a requirement that the transferee not be owned or controlled by foreign persons (particularly if the venture has government contracts), or any number of other matters.)

When preparing transfer restriction provisions, indirect transfers by a change in control of a participant should be considered. A change in control may be defined to include (i) a transfer of stock in a venturer by its ultimate parent entity, (ii) a change in management in the venturer in which specified individuals cease to be in control or (iii) a change in control of an ultimate parent entity.

[29] *See* Stephen Glover, et al., *Recent Trends in Joint Venture Governance*, 26 INSIGHTS 2 (Feb. 2012).

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G. Defaults

Joint venture agreements often specify the events constituting an event of default by a venture participant and the remedies of the other participants upon a default.[30] The partici-

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[30] *Id.* at 111-25. Article 8 of the ABA Model Joint Venture Agreement defines and establishes remedial processes for defaults by venturers as follows:

Article 8: Dissolution and Other Rights Upon Default

8.1 Applicability. This Article applies only if (a) only one Member is a Defaulting Member, in which case the Non-Defaulting Member may elect to terminate the Company in accordance with Section 8.3 (Remedies Upon Default by One Member), or (b) both Members are Defaulting Members, in which case Section 8.4 (Remedies if Both Members are Defaulting Members) will apply.

8.2 Definitions—Defaulting Member and Non-Defaulting Member and Default Event. ''Defaulting Member'' is a Member with respect to which any Default Event has occurred. A ''Non-Defaulting Member'' is a Member with respect to which no Default Event has occurred. Each of the following is a ''Default Event'':

(a) *Material Default*. Any material default by the Member in the performance of any covenant in this Agreement or in the performance of any material provision of any Related Agreement, which default continues for a period of 30 days after written notice thereof has been given by the Non-Defaulting Member to the Defaulting Member. A ''material default'' under this Section includes (i) any failure to make when due an Additional Capital Contribution or to make a required Member Loan in accordance with Section 3.2 (Additional Capital Contributions and Member Loans), (ii) any failure to make any payment when due under a Member Loan (See Section 3.2(c)—The Member Loans), (iii) any failure to make any payment when due under a Shortfall Loan (See Section 3.3(b)—Loan by Other Member) and (iv) a Critical Target Failure that is the result of a breach by a Member.

(b) *Material Breach*. A breach of any representation or warranty contained in Sections ____, ____ and ____ of Attachments 2.4-A or -B, any breach of which will be deemed to be a material breach for purposes of this Agreement.

(c) *Termination of Existence by a Member*. A Member commences any proceeding to wind up, dissolve or otherwise terminate its legal existence.

(d) *Termination of Existence by another Person*. Any Proceeding commenced against a Member that seeks or requires the winding up, dissolution or other termination of its legal existence; except if the Member defends or contests that Proceeding in good faith within 15 days of its commencement and obtains a stay of that Proceeding within 90 days of its commencement, a Default Event will not exist so long as the stay continues and the Member pursues the defense or contest diligently thereafter or the Proceeding is dismissed.

(e) *Dissociation*. The Member dissociates from the Company in violation of the prohibition against withdrawal in Section 2.3 (Term).

(f) *Prohibited Transfer*. The Member agrees to any transaction that would, if consummated, breach or result in a default under Section 6.1 (Restrictions on Transfer of Member Interests).

(g) *Change of Control*. There is a Change of Control of the Member or Person directly or indirectly controlling the Member, including a transfer pursuant to Section 6.2 (Assignment to Controlled Persons) (each a ''Target''). A ''Change of Control'' occurs when any of the following occurs:

(i) *Change in Ownership*. Any Person or group of Persons acting in concert acquires or agrees to acquire, directly or indirectly, either (A) that percent of the ownership interests of the Target that will provide the acquirer with a sufficient number of the Target's ownership interests having general voting rights to elect a majority of the directors or corresponding governing body or (B) in the case of a Target that has a class of securities registered under section 12 of the Securities Exchange Act of 1934, as amended, or that is subject to the periodic reporting requirements of that act by virtue of section 15(d) of that act, more than 30% of the Target's ownership interests having general voting rights for the election of directors or corresponding governing body.

(ii) *Board Approval of Acquisition*. The Target's board of directors or corresponding governing body recommends approval of a tender offer for 50% or more of the outstanding ownership interest of the Target.

(h) *Insolvency Proceeding*. If any of the following occurs: (i) the Member seeks relief in any Proceeding relating to bankruptcy, reorganization, insolvency, liquidation, receivership, dissolution, winding-up or relief of debtors (an ''Insolvency Proceeding''); (ii) the institution against the Member of an involuntary Insolvency Proceeding; *provided,*

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however, that if the Member defends or contests that Insolvency Proceeding in good faith within 15 days of its commencement and obtains a stay of that Proceeding within 90 days of its commencement, a Default Event will not exist so long as the stay continues and the Member pursues the defense or contest diligently thereafter or the Proceeding is dismissed; (iii) the Member admits the material allegations of a petition against the Member in any Insolvency Proceeding; or (iv) an order for relief (or similar order under non-U.S. law) is issued in any Insolvency Proceeding.

(i) *Appointment of a Receiver or Levy*. Either (i) a Proceeding has been commenced to appoint a receiver, receiver-manager, trustee, custodian or the like for all or a substantial part of the business or assets of the Member or (ii) any writ, judgment, warrant of attachment, warrant of execution, distress warrant, charging order or other similar process (each, a ''Levy'') of any court is made or attaches to the Member's Member Interest or a substantial part of the Member's properties; *provided, however,* that if the Member defends or contests that Proceeding or Levy in good faith within 15 days of its commencement and obtains a stay of that Proceeding or Levy within 90 days of its commencement, a Default Event will not exist so long as the stay continues and it pursues the defense or contest diligently thereafter or the Proceeding is dismissed.

(j) *Assignment for Benefit of Creditors*. The Member makes a general assignment for the benefit of creditors, composition, marshalling of assets for creditors or other, similar arrangement in respect of the Member's creditors generally or any substantial portion of those creditors.

8.3 Remedies—Upon Default by One Member.

(a) *By Non-Defaulting Member*. A Non-Defaulting Member may, within 90 days of becoming aware of the occurrence of a Default Event, give notice of the Default Event (a ''Default Notice'') to the Defaulting Member. The Default Notice must specify one of the following remedies (which, together with Section 8.3(c) and subject to Section 8.3(b), are exclusive remedies):

(i) *Dissolution*. Dissolution of the Company in accordance with Article 9 (Dissolution Procedures).

(ii) *Right to Buy*. The purchase of the Defaulting Member's Member Interest for 90% of Fair Market Value and otherwise in accordance with Article 11 (Buy-Sell Upon Default). The Non-Defaulting Member must propose the Fair Market Value in the Default Notice, which must be accompanied by a deposit in immediately available funds equal to 25% of the Defaulting Member's Book Capital Account as reflected in the annual financial statements of the Company for the Fiscal Year immediately preceding the year in which the Default Notice is given.

(iii) *Right To Sell*. The sale of the Non-Defaulting Member's Member Interest to the Defaulting Member for 100% of Fair Market Value and otherwise in accordance with Article 11 (Buy-Sell upon Default). The Non-Defaulting Member must propose the Fair Market Value in the Default Notice.

(b) *Other Remedies*.

(i) *Generally*. The Non-Defaulting Member's election to dissolve the Company under Article 9 (Dissolution) will not preclude its exercise of whatever rights it may also have under Article 14 (Indemnification) or at law. However, the Non-Defaulting Member's election to purchase the Defaulting Member's Member Interest under Section 8.3(a)(ii) (Right To Buy) or to sell its Member Interest under Section 8.3(a)(iii) (Right To Sell) is the election of an exclusive remedy.

(ii) *Certain Other Rights*. Notwithstanding the foregoing, no election under Section 8.3(a) will preclude either (A) the appointment of additional Managers by Small Member under Section 8.3(c) if Small Member is the Non-Defaulting Member, (B) the recourse by either the Defaulting Member or the Non-Defaulting Member to whatever injunctive relief to which it may otherwise be entitled under this Agreement or any Related Agreement or (C) the recourse by the Non-Defaulting Member under § 2.11(b) (Actions by Company) to recover amounts owing to the Company that are not specifically taken into account in the determination of Fair Market Value.

(iii) *Legal Fees and Expenses*. The Non-Defaulting Member's legal fees and expenses will be deducted from any distribution otherwise to be made to the Defaulting Member and will be paid to the Non-Defaulting Member or, if the Non-Defaulting Member elects, will be paid by the Defaulting Member to the Non-Defaulting Member.

(c) *Management Changes*. In addition to other rights a Member may have under this Section 8.3:

(i) if Small Member is the Non-Defaulting Member and it elects in its Default Notice the remedy in Section 8.3(a)(ii) (Right To Buy), it may, by simultaneously giving notice to the Defaulting Member and each Manager, also (A) appoint that number of additional Managers that will give Small Member a majority of the members of the Management Committee, (B) cause a simple majority of the members of the Management Committee to constitute a quorum, and (C) appoint the Chair of the Management Committee. Concurrently with that appointment, the appointee of pants' obligations to each other and to the joint venture may extend beyond funding and non-competition to such things as the provision of goods, services or personnel to the venture. A default in any of these obligations may be deemed a default under the joint venture agreement.

The participants may desire to structure disincentives to default, such as liquidated damages or other penalty provisions. Moreover, it may provide the non-defaulting participants with the right to buy out the interest of a defaulting participant, or to cause the dissolution of the joint venture, in addition to any damages resulting from the default. A purchase price for a buy-out provision of this type may be a specified discount from the fair market value of the interest as determined by a pre-established formula, by agreement of the parties or through a determination by a third party.

Where the joint venture obligations of a participant are guaranteed through a parent or other affiliate guarantee, certain circumstances or events in respect of the guarantor may also be deemed a default by the participant under the joint venture agreement. For example, the bankruptcy of a participant's guarantor may be deemed a default by the participant under the joint venture agreement.

H. Dispute Resolution

The joint venture agreement may provide for any number of dispute resolution mechanisms, including litigation, arbitration or other alternative forms of dispute resolution.[31]

Large Member will cease to be the Chair. However, in all cases the consent of at least one Manager appointed by each Member will continue to be required for the matters specified in Section 5.4 (Actions Requiring Management Committee Approval—Major); or

(ii) if the Non-Defaulting Member (which may be either Small Member or Large Member) elects in its Default Notice the remedy in Section 8.3(a)(i) (Dissolution), then concurrently with that notice and thereafter until the dissolution is completed or is terminated (A) the Non-Defaulting Member or its duly appointed representative will assume all of the powers and rights of the Management Committee and (B) its actions (1) will have the same effect as if taken by unanimous vote of the members of the Management Committee before the assumption and (2) will be deemed to include the consent of one Manager appointed by each Member to the matters specified in Section 5.4 (Actions Requiring Management Committee Approval—Major).

The management changes set forth in this Section 8.3(c) shall have effect only for so long as the Non-Defaulting Member is actively pursuing the remedy it elected under Section 8.3(a).

(d) *Effect of Notice*. If the Non-Defaulting Member elects in its Default Notice the remedy in Section 8.3(a)(i) (Dissolution), it will carry out that dissolution in accordance with Article 9 (Dissolution Procedures). If the Non-Defaulting Member elects in its Default Notice either to buy under Section 8.3(a)(ii) or to sell under Section 8.3(a)(iii) (and, in the former case, makes the required deposit), the Members will complete that purchase or sale, as applicable, in accordance with Article 11 (Buy-Sell Upon Default).

8.4 Remedies if Both Members are Defaulting Members. If both Members are, or become, Defaulting Members, simultaneously or sequentially, before a sale of a Member Interest under Section 8.3(a)(ii) or Section 8.3(a)(iii) has been completed, then notwithstanding any election previously made by a Non-Defaulting Member or steps taken to further such election, then (a) the Members and the Managers will proceed as expeditiously as possible to dissolve the Company in accordance with Article 9 (Dissolution Procedures) (other than Section 9.1(b)) as though such dissolution resulted from an election pursuant to Section 8.3(a)(i), and (b) both Defaulting Members will thereafter have whatever rights and remedies available to them under Article 14 (Indemnification) and under Applicable Law.

[31] *Id.* at 89-91. Article 5.9 of the ABA Model Joint Venture Agreement establishes dispute resolution procedures for disagreements regarding modifications to the Business Plan or the failure to obtain requisite approvals for specified actions as follows:

5.9 Dispute Resolution Procedures.

(a) *Failure to Approve Actions Requiring Special Approval by Management Committee*. If the Management

Whatever the mechanism, it is frequently provided that before any participant resorts to any such mechanism the dispute must be referred to specified senior level officers or managers of each participant for resolution. It is also important to provide for continued operation of the joint venture entity during the pendency of any dispute.

I. Termination

The joint venture governing documents typically specify the events, if any, which will cause a termination of the joint venture. Some agreements include a "termination for convenience" provision, under which any participant can force a termination of the joint venture, perhaps after a set period of time such as five years.[32] The joint venture agreements often include

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Committee has disagreed regarding (i) modifications to the then-current Business Plan and the disagreement has not been resolved at least ten Business Days before the beginning of the next Fiscal Year or (ii) any other action listed in Section 5.4 (Actions Requiring Management Committee Approval—Major) when properly submitted to it for a vote (either of which, a ''Business Dispute''), then the Managers will consult and negotiate with each other in good faith to find a mutually agreeable solution. If the Managers do not reach a solution within ten Business Days from the date the disagreement occurred and the failure to reach a solution, in a Member's judgment, materially and adversely affects the Company, then that Member may give notice to the other Member initiating the procedures under this Section (a ''Dispute Notice'').

(b) *Consideration by Member Executives*. Within two Business Days after the giving of the Dispute Notice, the Business Dispute will be referred by the Managers to the senior executive of each Member to whom the respective Managers report (each a ''Member Executive'') in an attempt to reach resolution. If the Member Executives are unable to resolve the Business Dispute within ten Business Days after the date of the Dispute Notice, or such longer period as they may agree in writing, then they will refer the Business Dispute to the chief executive officer of each Member. The chief executive officers will meet, consult and negotiate with each other in good faith. If they are unable to agree within twenty Business Days of the date of the Dispute Notice, then they will adjourn such attempts for a further period of five Business Days during which no meeting will be held. On the first Business Day following such period, the chief executive officers of the Members will meet again in an effort to resolve the Business Dispute. If the chief executive officers are unable to resolve the Business Dispute within 48 hours after the time at which their last meeting occurred, then Section 7.2(b) (Unresolved Business Dispute) will apply.

[32] *Id.* at 106-25. Article 8 of the ABA Model Joint Venture Agreement defines and establishes remedial processes for defaults by venturers and is set forth in note 30, *supra*. Article 7 of the ABA Model Joint Venture Agreement defines the venturers exit rights, either by dissolution or by purchase of sale of member interests, in the absence of a default as follows:

Article 7: Dissolution or Buy-Sell—in the Absence of Default

7.1 Applicability. This Article applies only if neither Member is a Defaulting Member (as defined in Section 8.2 (Definitions—Defaulting Member and Non-Defaulting Member and Default Event).

7.2 Triggering Events—Absence of Default. Either Member may elect a remedy set forth in Section 7.3 upon the occurrence of either of the following events:

(a) *Fundamental Failure*. The Company fails to achieve a Critical Target at the time specified in the Business Plan (''Critical Target Failure'') that is not a result of a material breach by a Member and the Members fail to agree upon and implement a plan to remedy that failure within 30 days (or such longer period as may be agreed by the Members) after either Member or any Manager has given notice of the failure to the Members and to each Manager.

(b) *Unresolved Business Dispute*. The occurrence of a Business Dispute unresolved under Section 5.9(b) (Consideration by Member Executives).

7.3 Remedies—Absence of Default. A Member may, within 90 days of becoming aware of the occurrence of either of the events specified in Section 7.2, give notice of the event to the other Member. The notice must specify one of the following alternative remedies (which are exclusive remedies):

(a) *Dissolution*. Dissolution of the Company in accordance with Article 9 (Dissolution Procedures).

(b) *Mandatory Buy-Sell*. Initiation of the sale of its Member Interest or the purchase of the other Member's Member Interest by giving the notice specified in Section 10.1 (Offer to Buy or Sell).

an affirmative obligation for each participant not to take any actions that would terminate the joint venture in violation of the other provisions of the joint venture agreement.

Rather than terminating the venture by terminating its business and winding up its affairs, a provision may be included for a non-defaulting participant to purchase the interests of the other participants. One method of providing for such an alternative is a "Dutch-auction" provision under which a participant may place a value on the entire joint venture and offer to purchase the interests of the other participants for their pro-rata shares of that value. Within a specified period of time, each other participant must then elect to purchase its share of the offering participant's interest at the value established by the offering participant or, failing to make such an election, must sell its interest to the offering participant at the price offered.

J. Antitrust

HSR Filing Requirements. Pre-merger notification filings under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (***"HSR"***) are generally required if all three of the following tests are met:[33]

(1)*The Commerce Test:* If either the acquiring and acquired person[34] is "engaged in commerce or any activity affecting commerce…"[35]

(2)*The Size-of-Person Test:* (i) One person in the transaction has a net sales or total assets of at least $136.4 million in sales or total assets, **and** (ii) the other party has at least $13.6 million in sales or total assets.[36]

(3)*The Size-of Transaction Test:* As a result of the transaction, (i) the acquiring person will hold an aggregate amount of stock and assets of the acquired person valued at least $68.2 million[37], **or** (ii) the acquiring person will hold an aggregate amount of voting securities[38] and assets of the acquired person valued at more than $272.8 million.[39]

In the case of a joint venture, even though the persons contributing to the formation of the unincorporated entity and the unincorporated entity itself may, in the formation transaction, be both acquiring and acquired persons within the meaning of HSR, for the above tests, the

If both Members give notices within that time period, the notice given first prevails.

7.4 Voluntary Buy-Sell. At any time after the third anniversary of the date of this Agreement (but not earlier), if no prior notice under Section 7.3 or Section 8.3 (Remedies—Upon Default of One Member) has rightfully been given, either Member may give a written notice to the other offering to purchase the other Member's Member Interest or sell its Member Interest to the other Member in accordance with Article 10 (Buy-Sell in Absence of Default).

[33] Clayton Act 7A, 15 U.S.C. § 18a (2006). The thresholds are adjusted each year based on the percentage change in the U.S. gross national product for the fiscal year. The most recent adjustment for 2012 appeared at 77 Reg. 4324 (Jan. 24, 2011), and was effective on February 27, 2012. For the first time in history, the thresholds were decreased in 2010.

[34] 16 C.F.R. § 801.2 (Jan. 11, 2006).

[35] 16 C.F.R. § 801.1(l) and § 801.3 (Jan. 11, 2006).

[36] 77 Reg. 4324 (Jan. 24, 2011), effective February 27, 2012, *available a*t http://www.ftc.gov/os/fedreg/2012/01/120124claytonact7a.pdf.

[37] 77 Reg. 4324 (Jan. 24, 2011), effective February 27, 2012, *available a*t http://www.ftc.gov/os/fedreg/2012/01/120124claytonact7a.pdf.

[38] 16 C.F.R. § 801.10 (Jan. 11, 2006).

[39] 77 Reg. 4324 (Jan. 24, 2011), effective February 27, 2012, *available a*t http://www.ftc.gov/os/fedreg/2012/01/120124claytonact7a.pdf.

contributors are deemed acquiring persons only and the joint venture is deemed the acquired person only.[40]

If an HSR filing were required, there could be a waiting period of at least 30 days before the joint venture could be consummated unless "early termination" were granted.[41]

Under current HSR rules, the formation of a "non-corporate entity" - including joint ventures - is reportable if the above tests are satisfied and a party gains "control" of the entity as a result of the transaction.[42] The HSR rules define a "non-corporate interest" as "an interest in any unincorporated entity which gives the holder the right to any profits of the entity or in the event of dissolution of that entity the right to any of its assets after payment of its debts."[43] These unincorporated entities include, but are not limited to, joint ventures, general partnerships, limited partnerships, limited liability partnerships, limited liability companies, cooperatives and business trusts. The HSR rules also provide that "control" is held by a person or entity with rights to 50% or more of the profits of the entity, or 50% or more of the assets upon the entity's dissolution.[44]

HSR Filing Fee Thresholds. The HSR filing fee thresholds, as of February 27, 2012 are as follows:[45]

Filing Fee	**Value of Transaction ($ millions)**
$45,000	More than $68.2 but less than $136.4
$125,000	$136.4 to less than $682.1
$280,000	$682.1 or more

General Antitrust Considerations. Whether or not pre-merger notification is required, the prospective joint venturers need to analyze whether the joint venture will be considered unlawful under antitrust law. While there is no clear test, a number of legal standards in the relevant case law as well as agency opinions, consent orders, guidelines and speeches are summarized in the Federal Trade Commission (***"FTC"***) and U.S. Department of Justice (***"DOJ"***) Antitrust Guidelines for Collaborations Among Competitors, available at http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf. In addition, if the joint venture is sufficiently similar to a horizontal merger, then the DOJ/FTC Horizontal Merger Guidelines, http://www.ftc.gov/bc/docs/horizmer.shtm (the ***"Guidelines"***), may apply.

[40] 16 C.F.R. § 801.50(a) (Jan. 11, 2006).

[41] Stephen M. Axinn et al., *Acquisitions under the Hart-Scott-Rodino Antitrust Improvements Act: A Practical Analysis of the Statute & Regulations* 1-14 (New York: Law Journal Press 3d ed. 2008).

[42] 16 C.F.R. § 801.1(a)(1) (Jan. 11, 2006).

[43] 16 C.F.R. § 801.1(f)(1)(ii) (Jan. 11, 2006).

[44] 16 C.F.R. § 801.1(b) (Jan. 11, 2006).

[45] *Filing Fee Information*, FEDERAL TRADE COMMISSION, http://www.ftc.gov/bc/hsr/filing2.shtm (last visited March 27, 2012).

K. Intellectual Property

Under federal law, intellectual property rights are not assignable, even indirectly as part of a business combination transaction among affiliated parties, unless the owner has agreed otherwise. This presumption of non-assignability is based on the concept that allowing free assignability would undermine the reward for invention. Where patent or copyright licenses constitute material assets to be contributed to a joint venture, the due diligence review should take into consideration not only the language of the license agreements, but also the federal law presumption against assignability of patent or copyright licenses.

In *Cincom Systems, Inc. v. Novelis Corp.*,[46] the U.S. Court of Appeals for the Sixth Circuit held that an internal forward merger between sibling entities constitutes an impermissible software license transfer, notwithstanding a state corporation statute that provides that a merger vests title to assets in the surviving corporation without any transfer having occurred.[47] The reasoning in the *Cincom* case follows that of *PPG Industries, Inc. v. Guardian Industries Corp.*,[48] which held that, although state law provided for the automatic transfer and vesting of licenses in the successor corporation in a merger without any transfer having occurred, an intellectual property license, based on applicable federal law, is presumed to be non-assignable and nontransferable in the absence of express provisions to the contrary in the license. *PPG* held the state merger statute was preempted and trumped by this federal law presumption of non-transferability.[49]

L. Confidentiality Agreement

A confidentiality agreement is the first stage for the due diligence process as parties generally are reluctant to provide confidential information to the other side without having the protection of a confidentiality agreement.[50] Confidentiality agreements in respect of joint ventures often are bilateral and provide that neither party, or any affiliate or associate of either of them, will use any of the information provided by the other for any purpose other than evalua-

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[46] Cincom Systems, Inc. v. Novelis Corp., 581 F.3d 431 (6th Cir. 2009).

[47] *Id.* at 437. The *Cincom* case involved Cincom's non-exclusive license of software to Alcan Rolled Products Division ("Alcan Ohio"), a corporation wholly owned by Alcan, Inc. The license agreement required Alcan Ohio, as licensee, to obtain Cincom's written approval prior to any transfer of its rights or obligations under the agreement. As part of an internal corporate restructuring, Alcan Ohio eventually merged into Novelis Corp., another subsidiary of Alcan, Inc. This forward merger caused the software to be owned by a different entity, but it remained on the same computer specified by the license agreement and its use of the software by the surviving entity was unchanged. Cincom was not asked to, and did not, consent to the merger. *Id.* at 434.

In addition to showing that the operation of the software was unaffected, Novelis Corp. claimed the intent of the license agreement demonstrated no concern with preventing internal corporate reorganizations. Further, Novelis Corp. argued that Ohio substantive corporate law required the court to find no transfer occurred as a result of the internal merger. *Id.* at 435.

After considering these arguments, the Sixth Circuit found that the merger was a transfer in breach of the express terms of Cincom's license and held that software licenses did not vest with the surviving entity formed as part of a corporate restructuring. The court reached this conclusion notwithstanding Ohio's merger law that automatically vests assets with the surviving entity. Relying instead on federal common law, the court aligned itself with the presumption that, in the context of intellectual property, a license is non-transferable unless there is an express provision to the contrary. *Id.* at 439-40.

[48] PPG Industries, Inc. v. Guardian Industries Corp., 597 F.2d 1090 (6th Cir. 1979).

[49] *Id.*

[50] Bryon F. Egan, *Asset Acquisitions: Assuming and Avoiding Liabilities*, 116 PENN. ST. L. REV. 913, 930 (2012) ("Asset Acquisitions").

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tion of the proposed joint venture. A confidentiality agreement may also include a standstill clause that provides that neither party will acquire any securities or other interest in the other without the prior consent of the other.[51]

M. Letter of Intent

In some transactions, the parties do not sign a binding agreement until the closing. If a letter of intent has been executed that includes a no-shop provision and gives the buyer adequate opportunity to conduct due diligence, the buyer may resist becoming contractually bound until it is ready to close.[52] Conversely, the seller has an interest in not permitting extensive due diligence until the buyer is contractually bound. This is especially so in circumstances in which the buyer is a competitor or in which the seller is concerned that the due diligence process will necessitate or risk disclosure to employees, customers or competitors that the business is for sale.

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[51] In the context of discussing a joint venture between Anheuser-Busch and InBev for the distribution of InBev beer brands in the U.S. and how InBev had used knowledge of Anheuser-Busch to set the stage for its later takeover of Anheuser-Busch, the author commented:

> Many joint venture agreements include a "standstill" clause that prevents partners from buying up shares in each other, attacking each other's boards of directors, or making other moves that could be viewed as steps toward an unsolicited takeover attempt. [August Busch] The Third had opposed the idea of a deal that did not legally protect Anheuser's independence, and it would have been perfectly reasonable for Anheuser-Busch to force InBev to agree to a standstill. That never happened, though. By the time the companies' third round of talks got underway in 2006, demanding a standstill provision to ward against a takeover wasn't a major concern for [August Busch] The Fourth.
>
> In his defense, the joint venture was too small in scope to warrant a standstill agreement as a normal course of action. "I'm sure A-B could have raised it," said one company advisor. "I do think that would have been an interesting thing to bring up. But it also would probably have been outsized, relative to the scope of what that JV was."
>
> "If A-B continued along the path they were on and InBev continued on the path they were on, I don't know if a standstill would have mattered at some point," the advisor added. "Public pressure (to merge the companies) might have been fairly significant nonetheless. But that said, a standstill is a standstill, and it would certainly have been helpful in a raid defense."

Julie MacIntosh, *Dethroning the King: The Hostile Takeover of Anheuser-Busch, an American Icon* 144 (John Wiley & Sons, Inc. 1st ed. 2010).

[52] *See* Global Asset Capital, LLC vs. Rubicon US REIT, Inc., C.A. No. 5071-VCL (Del. Ch. Nov. 16, 2009), in which in the context of explaining why he granted a temporary restraining order enjoining the target and its affiliates from disclosing any of the contents of a letter of intent or soliciting or entertaining any third-party offers for the duration of the letter of intent, Delaware Vice Chancellor Laster wrote:

> [I]f parties want to enter into nonbinding letters of intent, that's fine. They can readily do that by expressly saying that the letter of intent is nonbinding, that by providing that, it will be subject in all respects to future documentation, issues that, at least at this stage, I don't believe are here. I think this letter of intent is binding . . . [A] no-shop provision, exclusivity provision, in a letter of intent is something that is important. . . . [A]n exclusivity provision or a no-shop provision is a unique right that needs to be protected and is not something that is readily remedied after the fact by money damages. . . . [C]ontracts, in my view, do not have inherent fiduciary outs. People bargain for fiduciary outs because, as our Supreme Court taught in Van Gorkom, if you do not get a fiduciary out, you put yourself in a position where you are potentially exposed to contract damages and contract remedies at the same time you may potentially be exposed to other claims. Therefore, it is prudent to put in a fiduciary out, because otherwise, you put yourself in an untenable position. That doesn't mean that contracts are options where boards are concerned. Quite the contrary. And the fact that equity will enjoin certain contractual provisions that have been entered into in breach of fiduciary duty does not give someone carte blanche to walk as a fiduciary. . . . I don't regard fiduciary outs as inherent in every agreement."

But see Paramount Comm. Inc. v. QVC Network Inc., 637 A.2d 34, 51 (Del. 1994) (noting that a board cannot "contract away" its fiduciary duties); *see also* ACE Ltd. v. Capital Re Corp., 747 A. 2d 95, 107-08 (Del. Ch. 1999).

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III. TRANSFERRING ASSETS TO A JOINT VENTURE

A. Overview

Transferring assets to a joint venture, including a division or a subsidiary, revolves around a purchase agreement between the buyer (the joint venture) and the selling entity (one of the joint venture parties) and sometimes its owners.[53] Purchases of assets are characterized by the acquisition by the buyer of specified assets from an entity, which may or may not represent all or substantially all of its assets, and the assumption by the buyer of specified liabilities of the seller, which typically do not represent all of the liabilities of the seller. When the parties choose to structure an acquisition as an asset purchase, there are unique drafting and negotiating issues regarding the specification of which assets and liabilities are transferred to the buyer, as well as the representations, closing conditions, indemnification and other provisions essential to memorializing the bargain reached by the parties. There are also statutory (e.g., bulk sales and fraudulent transfer statutes) and common law issues (e.g., de facto merger and other successor liability theories) unique to asset purchase transactions that could result in an asset purchaser being held liable for liabilities of the seller which it did not agree to assume.[54]

A number of things can happen during the period between the signing of a purchase agreement and the closing of the transaction that can cause a buyer to have second thoughts about the transaction. For example, the buyer might discover material misstatements or omissions in the seller's representations and warranties, or events might occur, such as the filing of litigation or an assessment of taxes, that could result in a material liability or, at the very least, additional costs that had not been anticipated. There may also be developments that could seriously affect the future prospects of the business to be purchased, such as a significant downturn in its revenues or earnings or the adoption of governmental regulations that could adversely impact the entire industry in which the target operates.

The buyer initially will need to assess the potential impact of any such misstatement, omission or event. If a potential problem can be quantified, the analysis will be somewhat easier. However, the impact in many situations will not be susceptible to quantification, making it difficult to determine materiality and to assess the extent of the buyer's exposure. Whatever the source of the matter, the buyer may want to terminate the acquisition agreement or, alternatively, to close the transaction and seek recovery from the seller. If the buyer wants to terminate the agreement, how strong is its legal position and how great is the risk that the seller will dispute termination and commence a proceeding to seek damages or compel the buyer to proceed with the acquisition? If the buyer wants to close, could it be held responsible for the problem and, if so, what is the likelihood of recovering any resulting damage or loss against the seller? Will closing the transaction with knowledge of the misstatement, omission or event have any bearing on the likelihood of recovering?

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[53] For a detailed discussion of asset purchase transactions, *see* Asset Acquisitions, *supra* note 50.

[54] These drafting and legal issues are dealt with from a United States (***"U.S."***) law perspective in the *Model Asset Purchase Agreement with Commentary*, which was published by the Negotiated Acquisitions Committee of the American Bar Association (*"ABA"*) in 2001 (the *"Model Asset Purchase Agreement"* or the *"Model Agreement"*). In recognition of how mergers and acquisitions (*"M&A"*) have become increasingly global, the Model Agreement was accompanied by a separate ABA Negotiated Acquisitions Committee volume in 2001 entitled *International Asset Acquisitions*, which included summaries of the laws of 33 other countries relevant to asset acquisitions, and in 2007 was followed by another ABA Negotiated Acquisitions Committee book, which was entitled *International Mergers and Acquisitions Due Diligence* and which surveyed relevant laws from 39 countries.

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The dilemma facing a buyer under these circumstances seems to be occurring more often in recent years. This is highlighted by the Delaware Chancery Court decisions in *IBP, Inc. v. Tyson Foods, Inc.*,[55] in which the Court ruled that the buyer did not have a valid basis to terminate the merger agreement and ordered that the merger be consummated, and *Frontier Oil Corp. v. Holly Corp.*,[56] in which the Court ruled a target had not repudiated a merger agreement by seeking to restructure the transaction due to legal proceedings commenced against the buyer after the merger agreement was signed. While these cases are each somewhat unique and involved mergers of publicly-held corporations, the same considerations will generally apply to acquisitions of closely-held businesses.[57] In the event that a buyer wrongfully terminates the purchase agreement or refuses to close, the buyer could be liable for damages under common law for breach of contract.[58] There is little case law dealing with these issues in the context of an asset transfer to a joint venture because, more often than not, the parties will attempt to reach a settlement rather than resorting to legal proceedings.

The issues to be dealt with by the parties to an asset transfer to a joint venture will depend somewhat on the structure of the transaction and the wording of the acquisition agreement. Regardless of the wording of the agreement, however, there are some situations in which a buyer can become responsible for a seller's liabilities under successor liability doctrines. The analysis of these issues is somewhat more complicated in the acquisition of assets, whether it be the acquisition of a division or the purchase of all the assets of a seller.

B. Alternative Structures for Transfers of Businesses to Joint Venture

The actual form of the sale of a business can involve many variations. Nonetheless, there are many common threads involved for the draftsman. The principal segments of a typical agreement for the sale of a business include:

- Introductory material (i.e., opening paragraph and recitals);
- The price and mechanics of the business combination;
- Representations and warranties of the buyer and seller;
- Covenants of the buyer and seller;
- Conditions to closing;
- Indemnification;
- Termination procedures and remedies; and

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[55] IBP, Inc. v. Tyson Foods, Inc. (*In re* IBP, Inc. S'holders Litig.), 789 A.2d 14 (Del. Ch. 2001).

[56] CA No. 20502, 2005 WL 1039027, (Del. Ch. Apr. 29, 2005).

[57] Nixon v. Blackwell, 626 A.2d 1366, 1380-81 (Del. 1993) (en banc) (refusing to create special fiduciary duty rules applicable in closely held corporations); s*ee* Merner v. Merner, 129 F. App'x 342, 343 (9th Cir. 2005) (California would follow approach of Delaware in declining to make special fiduciary duty rules for closely held corporations); *but see* Donahue v. Rodd Electrotype Co., 367 Mass. 578, 328 N.E.2d 505, 515 & n. 17 (Mass. 1975) (comparing a close corporation to a partnership and holding that "stockholders in the close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise that partners owe to one another").

[58] *See* Rus, Inc. v. Bay Industries, Inc. and SAC, Inc., No. 01 Civ. 6133 (GEL), 2004 WL 1240578 (S.D.N.Y. May 25, 2004), discussed in the Comment to Section 11.4 of the Model Agreement *infra*.

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- Miscellaneous (boilerplate) clauses.

There are many basic legal and business considerations for the draftsman involved in the preparation of agreements for the sale of a business. These include federal income taxes; state sales, use and transfer taxes; federal and state environmental laws; federal and state securities laws; the accounting treatment; state takeover laws; problems involving minority shareholders; the purchaser's liability for the seller's debts and contingent liabilities; insolvency and creditors' rights laws; problems in transferring assets (mechanical and otherwise); state corporation laws; stock exchange rules; pension, profit-sharing and other employee benefit plans; antitrust laws; foreign laws; employment, consulting and non-compete agreements; union contacts and other labor considerations; the purchaser's security for breach of representations and warranties; insurance; and a myriad of other considerations.[59]

There are three basic forms of business acquisitions:

(i) Statutory business combinations (e.g., mergers, consolidations and share exchanges);

(ii) Purchases of shares; and

(iii) Purchases of assets.

C. Mergers and Consolidations

Mergers and consolidations involve a vote of shareholders, resulting in the merging or disappearance of one corporate entity into or with another corporate entity. Mergers and consolidations can be structured to be taxable or non-taxable for federal income tax purposes. Simply stated, if stock is the consideration for the acquisition of the non-surviving corporation, the merger can qualify as an "A" reorganization (IRC § 368(a)(1)(A)). Thus, a shareholder of the target corporation receives stock in the purchasing corporation wholly tax-free. However, a shareholder of the target company who receives only "boot" (i.e., consideration other than purchaser's stock or other purchaser securities under certain circumstances) is normally taxed as if the shareholder had sold his stock in the target corporation in a taxable transaction. Generally stated, a shareholder who receives both stock and boot is not taxed on the stock received but is taxed on the boot. The boot is taxed either as a dividend or as a capital gain, but not in excess of the gain which would have been realized if the transaction were fully taxable.

D. Purchases of Shares

Purchases of shares of the target company can likewise be handled on a taxable or non-taxable basis. In a voluntary stock purchase, the acquiring corporation must generally negotiate with each selling shareholder individually. An exception to this is a mechanism known as the "share exchange" permitted by certain state business corporation statutes[60] under which the vote of holders of the requisite percentage (but less than all) of shares can bind all of the shareholders to exchange their shares pursuant to the plan of exchange approved by such vote.

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[59] *See* Byron F. Egan, *The Roles of an M&A Lawyer*, INSIDE THE MINDS: STRUCTURING M&A TRANSACTIONS (2007); George W. Dent, Jr., *Business Lawyers as Enterprise Architects*, 64 BUS. LAW. 279 (Feb. 2009).

[60] *See, e.g.* TEX. BUS. ORG. CODE ANN. §§ 10.051, 10.053, 10.054, 10.056 (Vernon 2006), § 10.055, 21.454 (Vernon 2007), § 10.052 (Vernon 2011).

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Generally speaking, if the purchasing corporation acquires the stock of the target corporation solely in exchange for the purchaser's voting stock and, after the transaction the purchasing corporation owns stock in the target corporation possessing at least 80% of the target's voting power and at least 80% of each class of the target corporation's non-voting stock, the transaction can qualify as a tax-free "B" reorganization.[61]

Note that one disadvantage of an acquisition of the target corporation's stock is that the purchasing corporation does not obtain a "step-up" in the basis of the target corporation's assets for tax purposes. If the stock acquisition qualifies as a "qualified stock purchase" under IRC §338 (which generally requires a taxable acquisition by a corporation of at least 80% of the target corporation's stock within a 12-month period), an election may be made to treat the stock acquisition as a taxable asset purchase for tax purposes. However, after the effective repeal of the *General Utilities* doctrine, discussed *infra*, IRC §338 elections are seldom made unless the target is a member of a group of corporations filing a consolidated federal income tax return (or, since 1994, an S corporation) and the seller(s) agree to an IRC §338(h)(10) election, which causes the seller to bear the tax on the deemed asset sale since the present value of the tax savings to the buyer from a stepped-up basis in target's assets is less than the corporate-level tax on the deemed asset sale.

E. Asset Purchases

Generally speaking, asset purchases feature the advantage of specifying the assets to be acquired and the liabilities to be assumed. A disadvantage involved in asset purchases in recent years, however, has been the repeal, pursuant to the Tax Reform Act of 1986, of the so-called *General Utilities* doctrine. Prior to then, the Code generally exempted a "C" corporation from corporate-level taxation (other than recapture) on the sale of its assets to a third party in connection with a complete liquidation of the corporation and the distribution of the proceeds to its shareholders. After the effective repeal of the *General Utilities* doctrine, a "C" corporation generally recognizes full gain on a sale of assets even in connection with a complete liquidation. Thus, if a purchasing corporation buys the target's assets and the target corporation liquidates, the target pays a corporate-level tax on its full gain from the sale of its assets (not merely the recaptured items). The shareholders of the target are taxed as if they had sold their stock for the liquidation proceeds (less the target's corporate tax liability). Absent available net operating losses, if the sale is a gain, the *General Utilities* doctrine repeal thus makes an asset sale less advantageous for the shareholders.

Generally speaking, for a non-taxable acquisition of assets, the purchaser must acquire "substantially all" of the target's assets solely in exchange for the voting stock of the purchaser. See IRC §368(a)(1)(C). Basically, a "C" reorganization is disqualified unless the target distributes the purchaser's stock, securities and other properties it receives, as well as its other properties, in pursuance of the plan of reorganization.

There are a number of other tax requirements applicable to tax-free and taxable reorganizations, too numerous to cover in this outline.

[61] *See* 26 U.S.C.A. § 368 (West 2011).

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