Joint Venture Agreement

Between

Large Member

and

Small Member

Dated effective as of _____ , 200 _____

The Member Interests and/or Units of [Company] (the ''Member Interests'') are subject to the restrictions on transfer and other terms and conditions set forth in this Agreement. The Member Interests have been acquired for investment only and have not been registered under (a) the Federal Securities Act of 1933, as amended or (b) any other state securities law. The Member Interests may not be offered for sale, pledged, hypothecated, sold, assigned, or transferred, except in compliance with (i) such laws and (ii) the terms and conditions of this Agreement.

Comment: This legend is included for the reasons explained in the Commentary to Model Joint Venture Agreement §§ 2.10 and 6.1.

Contents

Exhibits

Note: To be supplied by business people, but need to determine whether have ‘‘Critical Targets’’ that need to be addressed as a ‘‘termination event’’ (See Model JV Agreement § 5.8).

Joint Venture Agreement

This is a Joint Venture Agreement (together with all Attachments and Exhibits and amendments to it, this ‘‘Agreement’’) between _____ , a _____ corporation (‘‘Large Member’’), and _____ , a _____ corporation (‘‘Small Member’’), and dated [as of] _____ _____ , 200 _____ .

RECITALS

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’’).

NOW, THEREFORE, in consideration of the premises and mutual promises

contained in this Agreement (the mutuality, adequacy and sufficiency of which are hereby acknowledged), the parties agree as follows:

Comment

This statement of the parties, the recitals and the consideration are in their basic approach very straightforward.

Under DLLCA § 18–101(7), a limited liability company is not required to execute its limited liability company agreement, but a limited liability company is bound by its limited liability company agreement whether or not the limited liability company executes its limited liability company agreement.

The recitals contain some important definitions, particularly ‘‘Business.’’

The stated Business could have a significant impact on the ability of a member to undertake or continue similar business activities apart from the Company. Article 15 (Competition) deals with competition between members.

The Model JV Agreement assumes that each joint venturer, rather than a wholly owned subsidiary of each joint venturer formed specifically for the purpose of becoming a member of the joint venture, will be the parties to the Model JV Agreement. This is because the limited liability company structure of the Model JV Agreement insulates each joint venturer from liability (unlike, for example, a general partnership structure). If a joint venturer instead decides to use a wholly owned subsidiary as the member of the joint venture, then the other joint venturer will want to consider whether a parent guarantee is appropriate in light of the monetary nature of many of the obligations in the Model JV Agreement, including the indemnification and buy-sell obligations.

Article 1: Definitions and Rules of Construction

1.1 Certain Defined Terms. Capitalized terms used in this Agreement have the meanings indicated in Attachment 1.1.

1.2 Rules of Construction. Attachment 1.1 also contains rules of construction.

Comment

Defined Terms

The approach taken in the Model JV Agreement is:

(1) to define technical concepts (such as ‘‘Additional Capital Contributions’’) in the section where either they are first or most frequently used and

(2) to define routine terms (such as ‘‘Applicable Law’’ ‘‘GAAP’’ and ‘‘Party’’) in a separate attachment (Part One of Attachment 1.1).

Attachment 1.1 also lists cross-references to terms defined in the text of the Model JV Agreement.

This is designed to allow a reader (particularly a business person) to get quickly to the substance of the Model JV Agreement without having to read through—at the front of the Model JV Agreement’s main body—many pages of definitions, many of which are highly technical in nature and difficult to understand (particularly as to implications) except in the context in which they are used and others of which are obvious.

This approach is not intended to indicate either that defined terms are of any less importance than if they were placed in the main body of the Model JV Agreement or that they should be of interest only to lawyers. While business people may focus much less on definitions than lawyers involved in the transaction, the lawyers ought to be careful to draw the attention of the business people to those definitions that are crucial to an understanding of substantive business issues dealt with in the Model JV Agreement.

Rules of Construction

The rules of construction in Part Two of Attachment 1.1 are self-explanatory. This approach puts in one place fairly typical rules of construction, such as the disclaimer as to the effect of titles and captions, the interchangeability of genders, and the incorporation of exhibits.

Article 2: Establishment of the Company

General Comment

This Article first sets forth the establishment of the joint venture entity as a Delaware limited liability company (Section 2.1) and its term (Section 2.3). The remaining sections address the formation, much as an asset purchase agreement.

2.1 Establishment of the Company.

(a) *Generally.* At the Closing (as defined in Section 2.7), the Members will establish the Company pursuant to the Delaware Limited Liability Company Act, Del. Code Ann. tit. 6, § 18–101 et seq. (1992) (the ‘‘DLLCA’’).

(b) *Applicability of the DLLCA.* To the extent that a Member’s rights and obligations with respect to, and the administration, dissolution, liquidation and termination of, the Company are not set forth in this Agreement (which constitutes the Company’s limited liability company agreement), they will be governed by the DLLCA. To the extent that this Agreement contains a provision contrary to a DLLCA provision that permits its being overridden by a limited liability company agreement, that DLLCA provision is overridden by such contrary provision in this Agreement whether or not specific reference is made to the overridden provision of the DLLCA.

Comment

DLLCA § 18–1101(b) sets forth the general rule that the limited liability company agreement is the basic governing authority among the members, in stating that it is the policy of the DLLCA to give the maximum effect to the principle of freedom of contract and the enforceability of limited liability company agreements. Only the implied contractual covenant of good faith and fair dealing may not be eliminated by a limited liability company agreement. DLLCA § 18–1101(c).

Thus, while the first sentence of Section 2.1(b) generally accepts the ‘‘default rules’’ of the DLLCA, the second sentence expressly recognizes the parties’

intention to override those default rules when the Model JV Agreement provides for a different approach permitted by the DLLCA. In addition, some specific references to overridden provisions are made in the applicable provision of the Model JV Agreement (see Sections 4.6 and 5.10(d)).

(c) *Purpose; the Business.* The Company may construct, operate and manage the Facility and engage in the Business. Consistent with the foregoing, the Company may: (i) exercise all other powers necessary to or reasonably connected with the Business that may be legally exercised by limited liability companies under the DLLCA; and (ii) engage in all activities necessary, customary, convenient, or incident to any of the foregoing.

Comment

DLLCA § 18–106(a) permits an LLC to carry on ‘‘any lawful business, purpose or activity, whether or not for profit, with the exception of the business of banking as defined in § 126 of Title 8.’’ However, the Model JV Agreement contemplates that the joint venture has a defined focus—and that affects business opportunities and competition (see Article 15).

(d) *No Personal Liability of Members.* No Member, Manager, Officer, employee or agent will have any personal liability to third parties for any debt, obligation, liability or loss of the Company, all as provided in the DLLCA.

Comment

This restates DLLCA § 18–303 and is unnecessary, but is fairly typical of LLC operating agreements.

(e) *Waiver of Rights.* Each Member hereby expressly waives, on behalf of itself and its successors and assigns, any and all rights to dissolve, terminate or liquidate, or to petition a court for the partition, dissolution, termination or liquidation of the Company, except as provided in this Agreement.

Comment

The Uniform Limited Liability Company Act (‘‘ULLCA’’) prohibits an

operating agreement from varying the right to have the LLC dissolved by court decree. ULLCA § 103(b)(6). The DLLCA does not contain such a prohibition, but it is silent on the issue of whether members can restrict or waive the right to judicial dissolution under DLLCA § 18–802. Such waivers may be unenforceable in Delaware. *See Johnson v. Foulk Rd. Med. Ctr. P'ship*, 2001 Del. Ch. LEXIS 143 (Del. Ch. Nov. 21, 2001 (upholding provision to arbitrate claim for judicial dissolution); *Sivsa Entertainment v. World Intern. Network*, 2004 WL 1895080 (Cal.App. 2 Dist. Aug 25, 2004) (waiver not enforceable under California LLC act); *Schimel v. Berkun*, 264 A.D.2d 725, 696 N.Y.S.2d 49, 1999 N.Y. App. Div. LEXIS 9064 (N.Y. App. Div. 2d Dep't 1999) (waiver contrary to public policy). The drafter should review applicable law of the state where the Company will be organized to determine whether the waiver in this Section 2.1(e) is enforceable.

(f) *Limited Right to Resign.* No Member may resign except with the consent of Members owning a majority of the Units (which may be withheld for any reason or for no reason). Any resignation by a Member in violation of this Section 2.1(f) is a Default Event under Section 8.2 (Default Events). The amount, if any, of any distribution that a resigning Member is entitled to receive upon resignation will be determined by Members owning a majority of the Units. The foregoing expressly override the contrary provisions of DLLCA § 18–604 as to distributions upon resignation.

Comment

This subsection is probably unnecessary in light of DLLCA § 18– 603, but seems advisable to include. The drafter ought to consider whether ''a majority of the Units'' should be changed to a higher (or lower) standard.

(g) *No Cessation of Membership upon Event of Bankruptcy.* Without limiting the rights of a Non-Defaulting Member under Article 8 (Dissolution and Other Rights Upon Default), a Member will not cease to be a Member of the Company upon the happening of

any of the events set forth in DLLCA § 18–304.

Comment

This is to override the provisions of DLLCA § 18–304, which, generally speaking, provides that a person ceases to be a member of a limited liability company upon an event of bankruptcy, and which could potentially conflict with the provisions of Article 8 dealing with the rights of a Non-Defaulting Member upon default.

2.2 Name. The name of the Company is "_____ , LLC.''

Comment

DLLCA § 18–102 requires that the name contain the words ''Limited Liability Company'' or the abbreviation ''L.L.C.'' or the designation ''LLC.'' Before selecting a name, the drafter should consider state filing requirements (including fictitious name requirements), trade name/trademark issues, domain names and the like, including possible infringement on existing protected property rights.

2.3 Term. The joint venture will continue until the Company is dissolved in accordance with this Agreement and the DLLCA.

Comment

DLLCA § 18–801(a)(1) provides that a limited liability company is dissolved at the time specified in its limited liability company agreement, but if no such time is specified, then the limited liability company has perpetual existence. But see DLLCA § 18–801 for other events causing the dissolution of a limited liability company.

2.4 Representations and Warranties. Large Member makes the representations and warranties set forth in Attachment 2.4-A, and Small Member makes the representations and warranties set forth in Attachment 2.4-B. SMALL MEMBER ACKNOWLEDGES AND AGREES THAT THE ONLY REPRESENTATIONS AND WARRANTIES MADE BY LARGE MEMBER ARE THE REPRESENTATIONS AND WARRANTIES SET FORTH IN ATTACHMENT 2.4-A, AND SMALL MEMBER HAS NOT RELIED UPON ANY

OTHER REPRESENTATIONS, WARRANTIES OR OTHER INFORMATION MADE OR SUPPLIED BY OR ON BEHALF OF LARGE MEMBER OR BY ANY AFFILIATE OR REPRESENTATIVE OF LARGE MEMBER. LARGE MEMBER ACKNOWLEDGES AND AGREES THAT THE ONLY REPRESENTATIONS AND WARRANTIES MADE BY SMALL MEMBER ARE THE REPRESENTATIONS AND WARRANTIES SET FORTH IN ATTACHMENT 2.4-B, AND LARGE MEMBER HAS NOT RELIED UPON ANY OTHER REPRESENTATIONS, WARRANTIES OR OTHER INFORMATION MADE OR SUPPLIED BY OR ON BEHALF OF SMALL MEMBER OR BY ANY AFFILIATE OR REPRESENTATIVE OF SMALL MEMBER.

Comment

Representations and Warranties (Section 2.4), Covenants Pending Closing (Section 2.5) and Closing Conditions and Termination (Section 2.6) are contained in Attachments rather than in the main text. Unlike an acquisition agreement, a joint venture agreement will be used and referred to many times over the life of the venture. Putting such items in attachments unclutters the Model JV Agreement text and makes the on-going limited liability company agreement easier to use.

The prospective joint venturers' representations and warranties are their formal description of each of them and their respective businesses, and are a key component of (1) closing conditions and, thus, termination rights (see Section 2.6) and also (2) indemnification (Article 14).

Absence of Substantive Distinction Between Representations and Warranties. In the merger and acquisition practice, the technical difference between representations and warranties—representations are statements of past or existing facts and warranties are promises that existing or future facts are or will be true—has proven unimportant. *See* James C. Freund, *Anatomy of a Merger: Strategies and Techniques for Negotiating Corporate Acquisitions* (1975). Furthermore, separating them explicitly in an acquisition agreement is a drafting nuisance, and the legal import of the

separation has been all but eliminated. *See Reliance Fin. Corp. v. Miller*, 557 F.2d 674, 682 (9th Cir. 1977) (the distinction between representations and warranties is inappropriate when interpreting a stock acquisition agreement). The Model JV Agreement follows this common practice and stipulates remedies for breaches of representations that are equivalent to those provided for breaches of warranties (see Attachment 1.1 (definition of ‘‘Breach’’) and Section 7.2 (Fundamental Failure), and Article 14 (Indemnification)). The commentary to the Model JV Agreement generally refers only to representations.

Because Section 14.10 provides that the Article 14 remedies are exclusive, the parties to the Model JV Agreement may not make claims in tort for breaches of an implied or express warranty if the description is basic to the bargain. *Cf.* U.C.C. § 2–313. *See generally Business Acquisitions* ch. 31 (John W. Herz & Charles H. Baller eds., 2d ed. 1981).

As is the custom in acquisition agreements, the Model JV Agreement includes two categories of representations: (1) representations made as of the date of the agreement; and (2) representations as remade as of the closing by delivery of the ‘‘bring down’’ certificate (see the discussion as to ‘‘Time as of Which Accuracy of Representation is Determined’’ in the Comment to Section 2.8).

The Model JV Agreement also provides typically for joint venture agreements, but reflecting a fundamental difference from acquisition agreements, for representations to be made at the time of an additional capital contribution (see Section 3.2(b)).

Significance and Implications of Representations. The representations made to induce the prospective joint venturers to enter into the joint venture agreement essentially serve the same purposes as the representations made in an acquisition agreement.

First, they are a device for obtaining disclosure about the other prospective joint venturer before the venture becomes effective. A thorough set of representations

elicits information about each member and its business relevant to the other prospective joint venturer's willingness to assume joint responsibility for assets and liabilities transferred into the business. For example, the Fact Pattern states that Large Member is contributing all of the assets related to development, manufacturing, sale and servicing of high technology equipment to be used by the joint venture. Clearly, Small Member has a vested interest in verifying before closing that its assumptions about the capabilities of Large Member's assets are valid and backed by representations designed to disclose those capabilities. Likewise, the Fact Pattern provides that Small Member is strong in the development of software for high technology equipment, an intellectual property skill Large Member lacks. Large Member needs to know, before closing, that Small Member's capabilities are more than puffery.

Second, the pre-closing representations provide a foundation for one prospective joint venturer's right to terminate the joint venture before or at the closing (see Section 2 of both Attachments 2.6-A and 2.6-B). After the signing of the joint venture agreement and before the effective date, each member usually continues its due diligence investigation of the other member. Detailed representations give each prospective joint venturer, upon subsequent discovery of adverse facts, the right not to proceed with the joint venture, even if the adverse facts do not rise to the level of common law ''materiality'' defined by judges in fraud and contract cases.

Third, the pre-closing representations affect each prospective joint venturer's right to indemnification by the other prospective joint venturer (and other remedies) if the breaching prospective joint venturer discovers a breach of any representation after the closing (see Article 14). In this regard, the representations, together with express indemnifications not tied to representations and warranties, serve as a mechanism for allocating economic risks between the members.

The period during which indemnification claims may be made is covered in Article 14

and is subject to negotiation. Some claims, such as those based on the condition of contributed property, are typically limited to a relatively short period of time following formation. Others, such as those based on the title to property or claims involving pre-formation products liability, litigation, violation of law and environmental matters survive for an extended period, such as the expiration of applicable statutes of limitation. Those made in connection with additional capital contributions survive for periods tied to the time of the additional capital contributions. Further (and as discussed below), ancillary documents (such as license agreements) may contain representations and indemnification obligations that are tied to the term of such agreement and, thus, may extend for a period beyond the term of the joint venture.

Scope of a Member's Representations. The scope of a member's representations largely will depend upon the relative bargaining power of the prospective joint venturers. If there is competition for a venture member, or if this particular venture presents a particularly attractive opportunity, a member might scale down the representations so as not to adversely affect its ability to close the transaction. In scaling down the representations, consideration must be given to their relative benefit to the other member in terms of the degree and likelihood of exposure and their materiality to the ongoing business operations.

While representations will reflect the relative concerns of each member, in a joint venture context there is often a practical limitation imposed on one member's asking for extensive representations that it would not itself be prepared to give since the other member may well then ask for corresponding representations to be given to it. In some cases, these concerns can be satisfied through the conduct of due diligence without having to obtain a specific representation. In other cases, one member will insist upon additional comfort from the other member through its representations backed up by indemnification.

The representations in the Model JV Agreement are based on the Fact Pattern that characterizes both Large Member and Small Member as in the field of manufacturing and selling competing high technology equipment. Large Member's market share is 10 percent while Small Member's is five percent. Both Large Member and Small Member use employees and their own networks of independent distributors for sales. While Large Member's strength is in research and development in the manufacture of systems and miniaturization, Small Member's strength is in the development of software for high technology equipment. Each will license these strengths to the joint venture and, because such license agreements may survive termination of the joint venture, those license agreements will contain specific representations that address intellectual property rights and protect against infringement of the licensed technologies.

Similarly, representations often are added to address specific concerns that pertain to the industry in which the giver operates. For example, representations concerning compliance with certain federal and state food and drug laws would be appropriate for a food products manufacturer or a medical device or drug manufacturer. The Fact Pattern indicates that neither member has subsidiaries that are joining the joint venture. If either were to have subsidiaries that are part of the assets being contributed to the joint venture, then representations should be expanded to include their organization, capitalization, assets, liabilities and operations. An example of the incorporation of subsidiaries in the representations and in certain other provisions of an acquisition agreement can be found in the *Model Stock Purchase Agreement with Commentary*. Similar changes should be made for any partnerships, limited liability companies or other entities owned or controlled by a member. The scope of the representations also changes over time to address current issues. Examples are the extensive environmental representations that began to appear in the 1980s and the Year 2000 representations that were commonly sought in the late 1990s.

Additionally one must address those representations that must continue after the closing, such as (1) absence of product liability claims or (2) compliance with applicable law of the products manufactured pursuant to tolling agreements before the joint venture's manufacturing plant becomes operational. Such issues may be best addressed (1) by specific indemnification or (2) by specific provisions of the tolling agreements.

Considerations When Drafting ''Adverse Effect'' Language in Representations. The importance of the specific wording of each joint venturer's representations cannot be overemphasized, because they provide the foundation for the other joint venturer's ''walk rights'' in Section 2.6 and indemnification rights in Article 14.

Consider, for example, the following seemingly simplified version of the litigation representation: *''There is no pending Proceeding that has been commenced by or against Large Member that will adversely affect Large Member's Product Business or any of the Large Member Contributed Assets.''* This language would be breached by any litigation, and provides complete protection to one member in the context of a post-closing indemnification claim against the other member. If there is a previously undisclosed lawsuit against a joint venturer that has an adverse effect on that joint venturer (because, for example, a judgment is ultimately rendered against the joint venturer in the lawsuit) that materially impacts the Company or the non-breaching joint venturer, the other joint venturer will be entitled to recover damages from the breaching joint venturer because of the breach of the litigation representation. However, the quoted phrase may not adequately protect the non-breaching joint venturer if the non-breaching joint venturer is seeking to terminate the agreement because of the lawsuit. To terminate the Model JV Agreement (without incurring any liability to the breaching joint venturer), the non-breaching joint venturer will need to demonstrate, on the scheduled closing date,

that the existence of the lawsuit violates the closing condition that the representations and warranties are true in all material respects because the litigation *will* have a material adverse effect on the business, operations, assets, conditions or prospects of the Company or the non-breaching joint venturer. The non-breaching joint venturer may find it difficult to make this showing, especially if there is doubt about the ultimate outcome of the lawsuit.

To address this problem, one joint venturer might be tempted to re-word the litigation representation so that it covers lawsuits that ‘‘*could reasonably be expected to have*’’ an adverse effect on the Company or the other joint venturer (as distinguished from lawsuits that definitely ‘‘will’’ have such an effect). However, while this change in wording clearly expands the scope of the ‘‘walk rights,’’ it may actually limit the non-breaching joint venturer’s indemnification rights because even if the lawsuit ultimately has an adverse effect on the Company or the non-breaching joint venturer, the breaching joint venturer may be able to avoid liability to the non-breaching joint venturer by showing that, as of the closing date, it was unreasonable to expect that the lawsuit would have such an effect.

To protect both its indemnification rights and its ‘‘walk rights’’ in the context of undisclosed litigation, one joint venturer may propose that the litigation representation be re-worded to cover any lawsuit ‘‘*that* **may** have an adverse effect’’ on the Company or the non-breaching joint venturer. If a joint venturer objects to the breadth of this language, the other joint venturer may propose, as a compromise, that the litigation representation be re-worded to cover lawsuits ‘‘*that will, or that could reasonably be expected to,*’’ have an adverse effect on the Company or the non-breaching joint venturer.

In the context of the Model JV Agreement, litigation against a joint venturer that does not affect the assets or business being transferred to the Company or its ability to meet its obligations under the business plan may not be viewed as properly giving the other

joint venturer a ‘‘walk right,’’ and a right to indemnification would not be present. The drafter needs to consider this in drafting representations, warranties, conditions and covenants throughout the agreement.

Considerations When Drafting Representations Incorporating Specific Time Periods. Representations that focus on specific time periods require careful drafting because of the ‘‘bring down’’ clause in the Model JV Agreement (the clause stating that the joint venturer’s representations must be accurate as of the closing date as if made on the closing date). In some acquisition agreements, a representation states that no notice of an alleged violation has been received at any time during a specified time period (such as a five-year period) *‘‘before the date of this agreement.’’* If the representation were drafted in this manner, the non-breaching joint venturer would not have a ‘‘walk right’’ if the breaching joint venturer received notice of a significant alleged violation between the signing date and the closing date—the representation would remain accurate as ‘‘brought down’’ to the scheduled closing date because the notice would not have been received ‘‘before’’ the date of the agreement. In contrast, if the representation were drafted to say ‘‘since’’ a date certain, the representation would be materially inaccurate as ‘‘brought down’’ to the scheduled closing date (because the notice of the alleged violation would have been received ‘‘since’’ the date specified), and the non-breaching joint venturer, therefore, would have a ‘‘walk right.’’

The Effect of ‘‘Knowledge’’ Qualifications in Representations. Both Large Member representations and Small Member representations contain ‘‘knowledge’’ qualifications. The addition of knowledge qualifications to the representations can significantly limit the non-breaching joint venturer’s post-closing indemnification rights (by shifting to the non-breaching joint venturer the economic risks of unknown facts). However, such qualifications should not affect the ‘‘walk rights’’ if the event becomes known before the closing. If, before the closing, one joint venturer learns of

a fact (not already known to the other joint venturer) that is inconsistent with a representation containing a knowledge qualification, the joint venturer should simply disclose this fact to the other joint venturer. The breaching joint venturer will thus acquire knowledge of the fact, and the representation will be inaccurate despite the knowledge qualification. **More importantly—**and specifically relating to special considerations in the context of a joint venture (beyond the normal ‘‘sandbagging’’ concerns)**—Section 14.1(b) limits the joint venturer’s indemnification rights for certain failures to disclose pre-closing knowledge of breaches. For further discussion of knowledge qualifications, see the Comments to the definition of ‘‘Knowledge’’ in Attachment 1.1 and, even more so, the comments to Section 14.1.**

The Absence of ‘‘Materiality’’ Qualifications. The representations in the Model JV Agreement generally do not contain materiality qualifications. Rather, the issue of materiality is addressed in the remedies sections. The attachments to Section 2.6 (Closing Conditions and Termination) specify that only material breaches of representations give the non-breaching joint venturer a ‘‘walk right.’’ Those attachments also take an approach that avoids a ‘‘doubled’’ walk right for the few representations that contain their own materiality qualification. The indemnification provisions replace a general and open-ended materiality qualification with a carefully quantified ‘‘deductible’’ in Section 14.5 that exonerates the breaching joint venturer from liability for breaches resulting in damages below a specified amount. Alternatively, the non-breaching joint venturer could acquiesce to some materiality qualifications but eliminate or reduce the ‘‘deductible’’ to prevent ‘‘double-dipping.’’ In the joint venture context, it may be that each joint venturer should be liable from ‘‘dollar one’’ as to pre-formation liabilities on a basis similar to the treatment of excluded liabilities in the asset purchase context.

The Effect of ‘‘Non-Reliance’’ Clauses. The last two sentences of Section 2.4 are

designed to limit the liability of both joint venturers to the representations and warranties in the Model JV Agreement and to defeat fraud claims by either joint venturer based on alleged misstatements or omissions in due diligence materials, management presentations or other information. Because reliance is an element of fraud, these non-reliance clauses are designed to preclude fraud suits, at least between sophisticated parties. Currently, courts are split as to the effectiveness of these so-called non-reliance clauses. The Second Circuit has awarded summary judgment based on a non-reliance clause in a sale agreement between sophisticated parties. *Harsco Corp. v. Segui*, 91 F.3d 337 (2d Cir. 1996). The First and Third Circuits, relying primarily on Section 29(a) of the Securities and Exchange Act of 1934, permit a non-reliance clause to be introduced as evidence of lack of reasonable reliance. *Rogen v. Ilikon Corp.*, 361 F.2d 260 (1st Cir. 1966); *AES Corp. v. Dow Chem. Co.*, 325 F.3d 174 (3d Cir. 2003). For a discussion of the conflicting and unsettled law as to non-reliance provisions, see the *Annual Survey of Judicial Developments Pertaining to Mergers and Acquisitions* by the Subcommittee on Recent Judicial Developments, Negotiated Acquisitions Committee, ABA Section of Business Law, 59 *THE BUSINESS LAWYER*. 1521 (Au-gust 2004). *See also* Robert F. Quintance, Jr., *Division of Opinion in the Colonies—Non-Reliance Clauses*, 7 No. 4, *The M&A Lawyer*, 17 (September 2003). For the effect of an integration clause, *see Kronenberg v. Katz*, 872 A.2d 568 (Del. Ch. 2004) (standard ‘‘integration’’ clause in the limited liability company agreement simply operated to prevent the variance of the agreement by parol evidence and was not, by itself, sufficient to bar a fraud claim). *See also ABRY Partners V, L.P. v. F&W Acquisition LLC*, 891 A.2d 1032 (Del. Ch. 2006) (agreement contained extensive non-reliance provisions; buyer not permitted to claim fraud with respect to matters outside the scope of the representations and warranties in the agreement).

2.5 Covenants Pending Closing. Until the Closing, Large Member and Small

Member will comply with the covenants set forth in Attachment 2.5.

Comment

The prospective joint venturers' covenants specifically describe actions to be taken between the date of the execution of the joint venture agreement and the closing date, and are a key component of closing conditions and, thus, termination rights (Section 2.6) and indemnification (Article 14).

A breach of a covenant in Attachment 2.5, like the breach of any other covenant under normal contract principles, will result in liability by the breaching member to the non-breaching member if the transaction does not close. It is clear that the breaching member will be liable to the non-breaching member for failure to perform its pre-closing covenants (*See* Sections 14.2(b) and 14.4(b)). However, if the prospective joint venturers choose to close and there is knowledge of a breach of a covenant, the non-breaching joint venturer will be foreclosed from recovering damages if the due diligence team leader of that member had actual knowledge of the breach (*See* Section 14.1(b)).

2.6 Closing Conditions and Termination. The conditions to Large Member's obligation to close and, if not satisfied, the right to terminate are set forth in Attachment 2.6-A. The conditions to Small Member's obligation to close and, if not satisfied, the right to terminate are set forth in Attachment 2.6-B.

Comment

Section 2.6 describes the conditions precedent to each prospective joint venturer's obligation to form the Company. If any one of the conditions is not satisfied as of the closing, the prospective joint venturer that is entitled to the benefit of the condition may decline to proceed with the transaction (without incurring liability to the other) and may terminate the agreement. A prospective joint venturer's right to refuse to consummate the transaction when a closing condition remains unsatisfied is often referred to as a ''walk right'' or an ''out.''

It is critical for the prospective joint venturers and their lawyers to appreciate the fundamental differences between closing conditions, on the one hand, and representations and covenants, on the other. While every representation and covenant of a member also operates as a closing condition (subject in many cases to a materiality qualification), some of the closing conditions in Attachments 2.6-A and 2.6-B do not constitute representations or covenants of a prospective joint venturer. If a prospective joint venturer fails to satisfy any of these closing conditions, the other will have the right to terminate the transaction, but unless there has also been a separate breach by a prospective joint venturer of a representation or covenant, the non-fulfilling prospective joint venturer will not be liable to the other for its failure to satisfy the condition. However, because of the prospective joint venturers' obligations to use their ''Best Efforts'' to satisfy all of the conditions in Attachments 2.6-A and 2.6-B and their undertakings in Sections 2.8(a)(iii) and 2.8(b)(iii) to provide at closing such instruments and take such actions as the other prospective joint venturer may reasonably request, even if a particular closing condition does not constitute a representation or covenant of the prospective joint venturers, they will be liable if they fail to use their Best Efforts to satisfy those conditions.

The importance of the distinction between conditions and covenants can be illustrated by examining the remedies that may be exercised by a prospective joint venturer if Proceedings referred to in Section 1.5 of each of the conditions attachments are commenced against the other prospective joint venturer. Because the absence of such Proceedings is a condition to each member's obligation to consummate the transaction, a prospective joint venturer may elect to terminate the transaction as a result of the presence of such Proceedings against the other. However, the absence of such litigation is not an absolute covenant of each prospective joint venturer. Accordingly, the presence of such

litigation will not, in and of itself, render a prospective joint venturer liable to the other. If a prospective joint venturer makes no attempt to terminate such litigation, however, it could be liable to the other under Section 2.5 for failing to use its Best Efforts to do so. A prospective joint venturer is not required to terminate such litigation if it is not commercially reasonable to do so.

A prospective joint venturer may waive any of the conditions to its obligation to close the transaction. However, the prospective joint venturer will not be deemed to have waived any of those conditions unless the waiver is in writing (see Section 17.4). This requirement avoids disputes about whether a particular condition has actually been waived.

2.7 Place and Time of Closing. The completion of the Formation Transactions (the ‘‘Closing’’) will occur at the offices of _____ , _____ , commencing at 10:00 a.m. (local time) on (a) _____ , 20 __ or, if later, the second Business Day following the satisfaction of closing conditions and effective as of the opening of business on such day, or (b) at such other date, time and place as the parties may agree.

2.8 Closing Deliveries. At the Closing:

(a) *Deliveries By Large Member*. Large Member will deliver:

(i) to Small Member and the Company each Related Agreement to which Large Member or any of its Affiliates is a party;

(ii) to Small Member and the Company a certificate executed by an authorized representative of Large Member to the effect that, except as otherwise stated in such certificate, each of Large Member’s representations and warranties pursuant to Section 2.4 is accurate in all material respects as of the date of this Agreement and as of the date of the Closing as if made on the date of the Closing (without giving effect to any supplements to disclosures made pursuant to Attachment 2.4-A delivered by Large Member to Small Member after execution of this Agreement

and before the date of the Closing);

Comment

Time as of Which Accuracy of Representations Is Determined. The representations and warranties attached pursuant to Section 2.4 are, by their nature, as of the date of the signing of the joint venture agreement. Section 2.8(a)(ii) and the corresponding Section 2.8(b)(ii)—referred to as the ‘‘bring down’’ clauses—require that the prospective joint venturers’ representations be ‘‘brought down’’ to the time of closing to determine whether they would be accurate if then made.

Although it is unlikely that a prospective joint venturer would object to the inclusion of a standard ‘‘bring down’’ clause, it may object to a clause that would require its representations and warranties to have been accurate on the original signing date. This clause would permit a prospective joint venturer to terminate the transaction because of a representation that was materially inaccurate when made, even if the inaccuracy has been fully cured by the closing. The other prospective joint venturer may point out that the elimination of such a clause would permit a prospective joint venturer to sign the joint venture agreement knowing that its representations are inaccurate at that time on the expectation that it will be able to cure the inaccuracies before the closing. This possibility could seriously undermine the disclosure function of a prospective joint venturer’s representations.

Effect of Schedule Supplements. Each of Sections 2.8(a)(ii) and 2.8(b)(ii) specifies that supplements to the applicable disclosure schedules have no effect for purposes of determining the accuracy of a prospective joint venturer’s representations and warranties *as of the date of closing*. This is consistent with a prospective joint venturer’s ability to not close by *excluding* the supplemental disclosures (see Section 1.1 of Attachments to Section 2.6) and not giving effect to such supplements for indemnification purposes (see Sections 14.2(a) and 14.4(a)) to assure preservation of its indemnification rights based on the signing date notwithstanding any disclosures

made by the other prospective joint venturer after the signing of the agreement (but with such indemnification rights subject to the knowledge of the party seeking indemnification, as discussed in the Comment to Section 2.4 and the Comment to Section 14.1(b)).

Operation of the ‘‘Bring Down’’ Clause. It is important that the prospective joint venturers and their lawyers understand how the ‘‘bring down’’ clauses in Sections 2.8(a)(ii) and 2.8(b)(ii) operate. Consider, for example, the application of this clause to the representation concerning a prospective joint venturer’s financial statements. This representation states that the financial statements *‘‘fairly present the financial condition...of the member as at the respective dates thereof.’’* Do the ‘‘bring down’’ clauses require, as a condition to a joint venturer’s obligation to close, that these historical financial statements also fairly reflect the other joint venturer’s financial condition as of the closing date? The answer to this question is ‘‘no.’’ The inclusion of the phrase *‘‘as at the respective dates thereof’’* in the representation precludes the representation from being ‘‘brought down’’ to the closing date. Nevertheless, to eliminate any possible uncertainty about the proper interpretation of the ‘‘bring down’’ clause, a prospective joint venturer may insist that the language of this clause be modified to include a specific exception for representations ‘‘expressly made as of a particular date.’’ The ‘‘no undisclosed liability’’ representation and warranty or a ‘‘no material adverse effect’’ closing condition can address these issues.

A prospective joint venturer may also seek to clarify that certain representations speak specifically as of the signing date and are not to be ‘‘brought down’’ to the Closing Date. For example, the prospective joint venturer may be concerned that a representation that states that the disclosure schedule accurately lists all of a prospective joint venturer’s contracts involving the performance of services or the delivery of goods or materials worth more than a specified dollar amount would be rendered inaccurate as of the closing date if the prospective joint venturer were to

enter into a significant number of such contracts as part of its routine business operations between the signing date and the closing date. A prospective joint venturer may also request that the ‘‘bring down’’ clause be modified to clarify that the other prospective joint venturer will not have a ‘‘walk right’’ if any of the representations is rendered inaccurate as a result of an occurrence specifically contemplated by the joint venture agreement. The requested modification entails inserting the words ‘‘except as contemplated or permitted by this Agreement’’ (or similar qualification) in Section 1.1 of the Attachments to Section 2.6. The other prospective joint venturer may object to the qualification requested because of the difficulty inherent in ascertaining whether a particular inaccuracy arose as a result of something ‘‘contemplated’’ or ‘‘permitted’’ by the transaction. *See* Lou R. Kling & Eileen T. Nugent, *Negotiated Acquisitions of Companies, Subsidiaries and Divisions* § 14.02[4] (1992). The other prospective joint venturer may argue that, if a prospective joint venturer is truly concerned about technical inaccuracies in its representations, it should bear the burden of specifically disclosing those inaccuracies in its disclosure schedule rather than relying on a potentially overbroad qualification in the ‘‘bring down’’ clause.

(iii) to Small Member and the Company an opinion of _____ , dated the date of the Closing, in the form of Exhibit 2.8(a)(iii); and

(iv) to Small Member such other documents as Small Member may reasonably request for the purpose of (A) evidencing the accuracy of any of Large Member’s representations and warranties, (B) evidencing the performance by Large Member of, or the compliance by Large Member with, any covenant or obligation required to be performed or complied with by Large Member, (C) evidencing the satisfaction of any condition referred to in Attachment 2.6-B, or (D) otherwise facilitating the consummation or performance of any of the transactions contemplated by this Agreement; and

(v) to the Company its capital contribution of $ _____ , consisting of

(A) $ _____ in cash and (B) the assets listed in Attachment 2.8(a)(v)-A (the ‘‘Large Member Contributed Assets’’) that Large Member will transfer by the transfer documents and deed listed in Attachment 2.8(a)(v)-B.

(b) *Deliveries By Small Member.* Small Member will deliver:

(i) to Large Member and the Company each Related Agreement to which Small Member or any of its Affiliates is a party;

(ii) to Large Member and the Company a certificate executed by an authorized representative of Small Member to the effect that, except as otherwise stated in such certificate, each of Small Member’s representations and warranties pursuant to Section 2.4 is accurate in all material respects as of the date of this Agreement, and as of the date of the Closing as if made on the date of the Closing (without giving effect to any supplements to disclosures made pursuant to Attachment 2.4-B delivered by Small Member to Large Member after execution of this Agreement and before the date of the Closing);

Comment

See Comments to Section 2.8(a)(ii).

(iii) to Large Member and the Company an opinion of _____ , dated the date of the Closing, in the form of Exhibit 2.8(b)(iii); and

(iv) to Large Member such other documents as Large Member may reasonably request for the purpose of (A) evidencing the accuracy of any of Small Member’s representations and warranties, (B) evidencing the performance by Small Member of, or the compliance by Small Member with, any covenant or obligation required to be performed or complied with by Small Member, (C) evidencing the satisfaction of any condition referred to in Attachment 2.6-A, or (D) otherwise facilitating the consummation or performance of any of the transactions contemplated by this Agreement; and

(v) to the Company its capital contribution to the Company of $ _____

_____ , consisting of (A) (the ‘‘Small Member Contributed Assets’’) $ _____ in cash and (B) the assets listed in Attachment 2.8(b)(v)-A that Small Member will transfer by the transfer documents listed in Attachment 2.8(b)(v)-B.

2.9 Initial Member Interests.

(a) *Generally*. Upon completion of the foregoing transactions, the Company will have initial capital of $ _____. The respective initial interests of the Members in the capital, net profits, net losses and distributions of the Company as represented by their Member Interests are as follows:

Name	Member Interests
Large Member	60.0%
Small Member	40.0%
Total	100.0%

Such percentages will change only (i) by amendment to this Agreement, (ii) by an assignment of a Member Interest permitted by this Agreement, (iii) by the issuance of additional Units in accordance with the terms of this Agreement, or (iv) to reflect additional capital contributions pursuant to Section 3.2 (Additional Capital Contributions and Member Loans). Such changes will be effective upon the effective date of the amendment, assignment, issuance or additional capital contribution, and the Company’s books will be closed as of such effective date so that allocations and distributions in accordance with Article 4 can be made to reflect such change in Member Interests. The percentages set forth above, as so changed, apply in all circumstances where relevant to determining the extent of the Member’s interest in the Company, including its rights to profits and losses, right to vote on, consent to or otherwise participate in any decision or action to be taken by the Members under this Agreement or the DLLCA.

(b) *Units.* Each Member’s Member Interest may be stated in terms of ‘‘Units.’’

For such purposes, initially each Member has Units equal to its initial Member Interest (so that, for example, Large Member has 60 Units at the date of this Agreement).

Comment

Subsection (a) is critical to documenting the agreed upon interests in the Company. See also related Section 3.1 (Initial Capital Contributions) and Section 3.2 (Additional Capital Contributions and Member Loans).

Subsection (b) is optional, and actual practice of including it varies greatly.

The Model JV Agreement is drafted so as to contemplate only two members, Large Member and Small Member. If additional members are added, several provisions of the Model JV Agreement (e.g., Article 5 (Management)) will need to be modified accordingly.

2.10 Treatment of Member Interests As Securities Under UCC Article 8

The Member Interests (a) will be treated as securities governed by _____ [statutory reference to applicable Article 8 of UCC] (but the designation of the Member Interest as securities for purposes of such law does not mean that they are securities for any other purposes) and (b) will be evidenced by certificates registered in the Company's books and that state that they are governed by such article. All certificates representing Member Interests will have written on their face or back a legend in substantially the following form:

THE MEMBER INTERESTS AND/OR UNITS REPRESENTED BY THIS CERTIFICATE ARE SECURITIES SOLELY FOR PURPOSES OF _____ ___ [APPLICABLE UCC ARTICLE 8].

CERTAIN RIGHTS, OBLIGATIONS AND RESTRICTIONS ARE IMPOSED ON THE MEMBER INTERESTS REPRESENTED BY THIS CERTIFICATE BY THE COMPANY'S LIMITED LIABILITY COMPANY AGREEMENT (AS IT MAY BE FROM TIME TO TIME AMENDED), A COPY OF WHICH IS IN

THE COMPANY'S RECORDS. THE TRANSFER, ENCUMBRANCE OR OTHER DISPOSITION OF MEMBER INTERESTS IN CONTRAVENTION OF SUCH AGREEMENT IS VOID. ANY TRANSFEREE OF MEMBER INTERESTS WILL BE BOUND BY SUCH AGREEMENT.

Certificates representing Member Interests (i) will be signed by the President (or other officer of the Company) and (ii) will be in such form as specified by the Management Committee (including legends in addition to those required by this Agreement).

Comment

While it is not an issue in Delaware (see DLLCA § 18–1101(g)), in many jurisdictions revised Article 9 of the Uniform Commercial Code provides that restrictions on the transfer of payment rights associated with certain classes of assets are generally unenforceable. That rule does not apply to ''securities'' that are governed by UCC Article 8. Section 2.10 represents the permitted election by the Company and the Members to have the Member Interests governed by UCC Article 8, thereby escaping the possible invalidation of the transfer restrictions contained in Article 6 and establishing the governing law for taking security interests in the Member Interests. This issue is discussed in detail in the Comments to § 6.1.

The ''opt-in'' for treatment of Member Interests as UCC Article 8 securities needs to be examined for implications under federal and state securities laws. For example, general partnership interests may not otherwise be ''securities'' for those purposes under *Williamson v. Tucker*, 645 F.2d 404 (5th Cir. 1981). *But see* J. William Callison, *Changed Circumstances: Eliminating the Williamson Presumption that General Partnership Interests Are Not Securities*, 58 *THE BUSINESS LAWYER*. 1373 (August, 2003). Because LLCs can take a variety of forms with differing degrees of involvement by the members in management of the LLC, courts have indicated that LLC interests will be analyzed on a case-by-

case basis depending on the facts and circumstances. *See Robinson v. Glynn*, 349 F.3d 166 (4th Cir. 2003) (finding that the LLC interest held by the plaintiff was not a security under federal securities laws, because the plaintiff had the ability to exercise meaningfully the powers granted to him under the LLC agreement and he had significant say in the management of the LLC).

2.11 Company Obligations & Rights.

(a) *Generally.* The Members will cause the Company to fulfill its obligations in this Agreement. The Company may, as a third party beneficiary or otherwise, independently enforce its rights under this Agreement, including those under Article 14 (Indemnification) and Article 16 (Confidentiality).

Comment

Section 2.11(a) authorizes the Company to enforce its rights under the joint venture agreement as a third party beneficiary. *See* DLLCA § 18–101(7).

(b) *Actions by Company.* Notwithstanding any provision to the contrary in this Agreement or under Applicable Law, any action by the Company to enforce its rights under this Agreement may be maintained by any Member at such Member's discretion.

Comment

DLLCA § 18–1001 authorizes derivative actions. The rights provided to each Member under Section 2.11 to bring actions in the name of the Company to enforce its rights under the joint venture agreement are in addition to those rights provided to the Members under Article 8 (Dissolution and Other Rights Upon Default) upon the occurrence of a Default Event with respect to a Member. However, Section 2.11 recognizes that certain breaches of the joint venture agreement may call for action against the breaching Member that do not warrant the triggering of the ''exit rights'' granted by Article 8.

Section 2.11(b) permits any Member to maintain an action in the name of the Company. If the decision to bring an action were left to both Large Member and

Small Member, the breaching Member could block the decision by voting against it. Alternatively, if the decision were subject to majority approval of the Management Committee, Large Member (if it were in breach of the Model JV Agreement) could block the decision through the tie-breaking vote of the Chair. Limited liability company agreement provisions restricting or limiting the right of any member to bring a derivative action also are of questionable enforceability under Delaware law. *See Vertical Computer Sys. v. Ross Sys.* 11 A.D. 375 (N.Y. App. Div. 2004) (citing the provisions of DLLCA § 18–1001, a New York court interpreting Delaware law held that LLC agreement provision requiring 75% of members to approve litigation was not a bar to any member bringing the action).

Article 3: Capital Contributions

General Comment

This Article sets forth fairly typical provisions as to the statement of initial capital contributions and the circumstances in which additional contributions (or loans) are made and remedies for failure to make them.

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:

Name	Initial Book Capital Account
Large Member	$
Small Member	$

Comment

As the introduction indicates, this is tied directly to the capital contributions made at the Closing pursuant to Section 2.8 (Closing Deliveries). This also ties to Section 2.9 (Initial Member Interests).

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.

Comment

Sections 5.4 and 5.8 set forth detailed provisions for the development, revision and approval of the Business Plan. The Model JV Agreement assumes that the Business Plan will deal with the need for, and the methods for raising, Additional Capital Contributions or Member Loans. If a business plan has not been adopted or approved at the time a joint venture agreement is signed, the drafter should consider an additional provision that deals with the circumstances in which additional capital contributions or loans can be made and tie them to the management provisions of Article 5 (see Sections 5.4 and 5.5). If each member has an equal vote, such an additional provision may be unnecessary since the recognition of a need for additional capital, as well as how it should be raised, will all be subject to future agreement of the members.

(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 representations 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.

Comment

The drafter may want to consider additional representations to include in the certificates depending on the specific facts as to the business, the capital contributions or loans and condition of the members.

(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.

Comment

The additional capital and member loan provisions outside of those referred to in the

Business Plan are difficult to anticipate. If all members cannot agree that the additional cash is required, it may be easy enough for a non-consenting member to agree that the consenting member may make a loan, but much more difficult for them to agree to the terms of such loan. Since the format chosen for the joint venture is a limited liability company, the non-consenting member will not have personal liability for the repayment unless specific provisions are negotiated. The consenting member would, of course, desire to negotiate default terms similar to those applicable to the failure to make a required capital contribution or loan as described below.

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).

Comment

The remedies of the Other Member set forth in this Section are exclusive. If the drafter adopts this approach of exclusivity, alternatives to the remedies specified and additional remedies should be considered. For example, the Other Member could be allowed to make an Additional Capital Contribution that increases its ownership interest rather than treating it as a Shortfall Loan as provided in Section 3.3(b). An additional remedy might allow the Other Member to make a Member Loan directly to the Company with a grant of security interest in Company assets and other related terms. It should also be noted that management control could shift after default pursuant to Section 8.3(c) (Management Changes). The period that must pass for such management change to occur needs to be carefully considered given (1) the need to quickly remedy problems caused by such default and (2) the need to provide an adequate cure

period before such significant change becomes effective. Any default in payments due under the Shortfall Loan as specified in Section 3.3(b) should permit the Other Member to foreclose on the Non-Contributing Member's interest in 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).

Comment

Note that Model JV Agreement § 3.3(b) provides that if one Member fails to make an Additional Capital Contribution or to make a required Member Loan when due, then the Other Member may make the contribution or loan on behalf of the Non-Contributing Member, in which case the Other Member is granted a security interest in the Member Interest of the Non-Contributing Member.

The UCC imposes specific restrictions on when and how a creditor can realize on its security and also requires that such realization be carried out in a commercially reasonable manner. While there is some scope to agree upon the standards by which commercial reasonableness is to be judged, the requirements of the UCC cannot generally be varied by agreement.

(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 Default).

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.

Comment

This is a very standard provision intended to keep the Company's capital in the Company and to ensure that a member's distributions are solely in accordance with Article 4 or the dissolution provisions.

Article 4: Allocation of Profits and Losses; Distributions

General Comment

This article addresses the issue of the allocation of profits and losses and the distribution of cash generated by the Company.

Note: These provisions assume that under the IRC's so-called ''check-the-box'' procedures the Company has not elected to be taxed as a corporation.

Article 12 has related accounting provisions.

Finally, in any event, these provisions need to be reviewed by a tax lawyer.

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).

Comment

DLLCA § 18–504 provides that distributions are made in accordance with contributions, unless otherwise provided in the limited liability company

agreement (as this section does). This section also incorporates various tax allocation provisions, most of which are in Attachment 12.

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.

Comment

Section 4.2 defines the fundamental concepts used in Section 4.3 for determining the cash distributions to the Members.

Section 4.2(c) establishes the amount of the tax distribution to be made

under Section 4.3(a) by reference to the cumulative results of the Company's activities. Other definitions would determine the distribution amount only by reference to the taxable income for the year in question. Such an approach would be a much simpler calculation. However, it could have a significant impact on the Company's cash availability and would not reflect the tax benefits resulting to the Members as a result of being able to utilize prior Company losses against their income from separate business activities or, if not so used, to utilize such losses to reduce their share of the current year's taxable income by reason of the net operating loss carryforward rules.

To illustrate the difference, if the Company's taxable income or loss history is:

Year 1	($300,000.00)
Year 2	($150,000.00)
Year 3	$100,000.00
Year 4	$400,000.00

and the Effective Tax Rate is 38%, then under the definition in Section 4.2(c), the Company would not make a distribution to its members in Year 3 and would distribute $19,000 in Year 4. Under the ''simple'' method, a distribution of $38,000 would be made in Year 3 and a distribution of $152,000 would be made in Year 4.

This formula does not reflect, as sometimes suggested, the repayment by a Member of prior tax distributions to reflect a current year's tax loss that offsets prior years' taxable income from the Company.

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.

Comment

Section 4.3 establishes the priority of distributions, as follows:

(1) Tax Amount

(2) Repayment of Member Loans

(3) Distributions to the Members

Section 4.3(e) provides for Other Available Cash to be distributed as determined by the Management Committee, taking into account the distribution policy set forth in Section 4.8. The suggested distribution policy is included in the agreement in order to clarify the members' objectives up front and to document, for future guidance of the Management Committee, how such distributions should be determined.

Because the Management Committee (which is controlled by Large Member through the tie-breaking vote of the Chair) has the authority to determine the amount and timing of distributions and reserves, and because Large Member may not have as great a need for and reserves, distributions as Small Member, Small Member may negotiate for more certainty as to distributions. To the extent that there is an expectation that the joint venture will generate cash flow in excess of anticipated operating expenses set forth in the Budget, then Small Member may desire to limit some of the discretion of the Large Member by requiring that a certain amount of cash flow after expenses and reserves that Small Member has agreed to in the Budget be distributed to the Members. This type of limitation will ensure that Large Member does not use its control over the joint venture's management committee to limit unduly distributions from

operating cash flows.

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 Section 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.

Comment

It should be noted that distributions of cash equal to the Tax Amount otherwise distributable to the Defaulting Member would be made to the Non-Defaulting Member and not to the Defaulting Member and may create economic hardship since taxes may be due without available cash to make the payments. However, the Defaulting Member may have other losses to offset income allocated to it. An alternative to consider is allowing the Defaulting Member to receive just the tax distributions pursuant to Section 4.3(a) and, as necessary, Section 4.3(e).

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.

Comment

The purpose of the distribution policy is to record the Members' agreement as to expectations for use of cash, specifically the extent to be retained and the extent to be distributed. Because Small Member may have a greater need to receive cash from the Company than Large Member, Small Member may negotiate for greater flexibility in distributing Cash Flow.

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

Article 5: Management

General Comment

The primary function of management provisions in a joint venture agreement is to set out the chosen framework for the governance of the venture and the respective roles

of the Members and/or their designated representatives in the ongoing guidance and supervision of the Company. The management provisions must be tailored to achieve the Members' and the venture's business objectives. They must also be designed to be workable and function as smoothly and efficiently as possible in the context.

The role of the Members and/or their designated representatives in management will depend upon the extent to which the Company is to be principally controlled by one Member or both and the extent to which the Members intend to rely on Company employees or professional managers to run the business.

The management provisions should be sufficiently developed at the outset in order to minimize future disputes and avoid having to subsequently resolve who can or should make decisions or authorize various actions.

Some important general issues for the prospective joint venturers to consider are:

1. the use of a management board comprised of Member representatives rather than direct Member control (in the Model JV Agreement, a Management Committee);
2. the extent of authority given to the management board (here, a Management Committee) and that reserved to the Members (in the Model JV Agreement, the Management Committee has the exclusive authority to manage or direct the management of the venture, with certain identified ''fundamental'' decisions requiring agreement by each Member's Management Committee representative, in effect a veto right for each Member);
3. the Members' choices of Management Committee appointees and their accountability to the Members and the Company;
4. the authority of the Management Committee to retain and remove senior officers, including the CEO;
5. the substantive standards and processes for dealing with nonarm's length

transactions and other conflict situations involving the Company and one of the Members against the backdrop of the dispute resolution provisions of the Model JV Agreement and applicable statutory requirements;

6 the process for developing, approving and updating the Business Plan and budget (here it is assumed that a comprehensive Business Plan exists at the outset that should help avoid future disputes over significant decisions, while allowing sufficient flexibility to account for future and unpredicted change); and

7 the methods of informally resolving deadlocks and business disputes, including reconsideration and ‘‘cooling off’’ periods.

The management provisions of the joint venture agreement are also the sections that are commonly used to clarify, and where permitted, modify the duties owed by the Members to each other, including specifically addressing those areas where such duties are most likely to be implicated, such as self dealing and business opportunities.

DLLCA § 18–402 provides that management is vested in the LLC’s members unless otherwise provided in the limited liability company agreement—as this article does. Some LLC acts require that the articles of formation specify that an LLC is to be manager managed in order to prevent a member from acting on behalf of the LLC (e.g., the right to convey real property).

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 5.1(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:

Large Member	Small Member
_____	_____
_____	_____

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 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.

Comment

There are a variety of ways in which the Members can choose to participate in the management of the Company. In the Model JV Agreement, the Members have delegated management authority to their representatives on a four-person Management Committee that will be responsible for managing or directing the management of the Company (Section 5.1(a)). The Members' appointees to the Management Committee, as a practical matter, will consult with and account to the Member that appointed them.

The number of Managers should reflect the management needs of the venture and the desires of the Members to have various departments or functions represented on the Management Committee. For example, each Member might want a representative with product development expertise, a representative with financial expertise, or a representative with marketing or sales expertise. Important considerations are whether each Member is represented equally in number and expertise on the Management Committee, the extent to which reliance will be placed on professional managers and the protections that are put

in place with respect to future changes in the management structure in the event of a default (Section 8.3(c)). While it is expected that a Member's representative will vote as directed by the Member and that two or more representatives would therefore be unnecessary, the use of a four-person management structure provides flexibility in the event that a Manager or his delegate is unable to participate in a meeting.

Section 5.1(b) also makes it clear that the Member has complete and continuing control over the choice of its representatives and may replace any appointee at any time. Some joint venture agreements, in order to avoid Manager personalities becoming an issue, provide the other Member with a prior consultation right or some type of limited screening right to promote the selection of compatible Managers. The concern is partly addressed in the Model JV Agreement by having the initial appointees identified (in Section 5.1(b)) before the deal is signed, thereby allowing each joint venturer, if it wishes, informally to raise any objection with the other over a proposed initial appointee.

By providing that each Member will pay the compensation and expenses of its Management Committee appointees, Section 5.1(c) allows each Member to decide on Manager compensation in ways that are compatible with its own compensation and benefits structure.

Each Manager (Section 5.1(e)(i)) and the CEO (Section 5.6(c)(v)) are given the authority in Section 5.1(e)(i) to execute documents on behalf of the Company subject to the important limitations in Section 5.1(e)(ii). Another more flexible alternative is to require that a Manager appointed by Large Member sign the documents spec-ified in Section 5.1(e)(ii). By requiring the signature of the Chair, or another Large Member appointee, on the more important documents, the limitations in Section 5.1(e)(ii) reinforce Large Member's ability to maintain control over significant transactions of the Company. The determinants of what documents are sufficiently

important are here based on the subject matter of the document and a dollar and duration threshold. Depending on the specific joint venture, prospective joint venturers may choose to list other variables or select other specific types of documents (IP licenses, customer contracts, etc.) as requiring special signing authority.

Small Member may want to have similar protections, for example, through a dual signature requirement for significant documents that relate to actions where its supermajority or veto right (Section 5.4) applies, but such a requirement would have to be consistent with the other approval requirements in Sections 5.4 and 5.5 in order to avoid Small Member having the ability through a dual signature requirement to thwart actions that the Model JV Agreement in Section 5.5 allows to be approved solely by Large Member.

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.

Comment

The process considerations in Section 5.2 are intended to contribute to the smooth operation of the management of the Company while addressing possible process-based actions that could be used to take advantage of one Member or the other. For example, the right in Section 5.2(a) to have regular meetings and the

right of the Small Member's representatives to call special meetings are designed to protect Small Member from being excluded from management or from not being able to have important issues formally addressed by the Management Committee.

Some joint venture agreements limit the number of special meetings that each Member's Management Committee representatives may call in order to balance Small Member's right to initiate the consideration of matters that are important to it against the agreed structure of giving the Chair, who is Large Member's appointee, control over the meeting process.

The provisions dealing with the role of the Chair and the fact that Large Member has the ongoing right to have its representative serve as Chair are important elements in effecting and maintaining Large Member's control over the Company. In other circumstances, joint venturers may want to rotate the chairmanship on an annual or other basis. The advantage of a rotating chairmanship is that the prospect of transferring the Chair to the other Member's representative produces an inclination among chairpersons to do unto others as you would have them do unto you. However, if Large Member were to accept a rotation of the chairmanship between its Managers and Small Member's Managers in the Model JV Agreement, Large Member would presumably want to retain the right to have a tie-breaking vote for actions under Section 5.5 and remove any limitations on the number of special meetings its Managers could call.

Other process considerations, such as permitting the participation at meetings by conference video or telephone, allowing for decisions by written consent and allowing for the use of delegates in place of representatives are all intended to contribute to an efficient and smoothly functioning management process taking into account the other demands that might typically be placed on the Managers

given their possible time or travel commitments. DLLCA § 18–407 authorizes the delegation of Model JV Agreement § 5.2(f).

Although the written consent provision will appear familiar to practitioners used to dealing with corporate boards, Small Member should consider whether to agree to this provision in the context of a two party joint venture. If it is important to Small Member that its view point be ‘‘heard’’ before an action is taken by Large Member, then Small Member might insist that the written consent provisions only be available after a meeting has been called and the representatives of Small Member fail to appear for such a meeting. To the extent Small Member desires such a process, it should be drafted to permit Large Member to act by written consent if Small Member’s representatives fail to appear at a properly called meeting. Such a provision would assure Small Member that its representative will always have an opportunity to make an argument before any action is taken, but would not permit Small Member to force Large member to go through unduly burdensome steps to take actions. Additionally, Small Member will want to carefully consider the notice provisions for meetings. If there are certain types of matters (for example, changes in tax policies or approval of an exclusive licensing arrangement) that Small Member’s representative might need more time in order to make an informed decision or to discern the impact on Small Member, then Small Member might want to insist that prior to such actions being presented at a meeting that a longer notice period be given prior to a vote on such actions. To the extent Small Member desires such special notice periods, Large Member will want to be careful that such provisions do not prevent Large Member’s representatives from taking the action once the notice period has lapsed and that such provisions do not raise ambiguity as to Large Member’s ability to direct the actions of the joint venture, i.e. any such exceptions should be described

narrowly and with specificity.

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.

(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.

Comment

The interrelationship between Sections 5.3(a) and 5.3(c) means that, except for ''supermajority'' matters in Section 5.4 over which Small Member in effect has a veto, Large Member can control the actions of the Management Committee so long as a quorum is present at a meeting and so long as Large Member is not in default. This power arises from Section 5.2(b) which gives Large Member control over the chair of the Management Committee and Section 5.3(b) which provides that if Large Member is not in default, the Chair will be able to exercise a tie-breaking vote to break ties and thereby satisfy the majority approval requirement in Section 5.3(a). Therefore, unless the matter is one over which Small Member has negotiated a veto right under Section 5.4, Small Member must rely on the

persuasiveness of its representatives and on the negotiated standard of conduct provisions in Section 5.10 if it wishes to have its views on a matter prevail before the Management Committee.

While the Model JV Agreement provides that the Chair can exercise a tie-breaking vote only if Large Member is not in default, the inclusion of a ‘‘no default’’ threshold for the exercise of a tie-breaking vote can be problematic. Deadlocks at the Management Committee will often occur where other problems have developed in the business relationship of the Members, and it could well be the case that Small Member might allege that Large Member is in default of some provision of the joint venture agreement. In order to maintain clear control of the Company in such circumstances, a joint venturer in Large Member’s position may want to either eliminate the ‘‘no default’’ threshold or require that it be conditioned on a finding of default under the dispute resolution provisions of the joint venture agreement that has not been cured.

The quorum provision in Section 5.3(c) provides a mechanism to prevent the business of the Company from being frustrated by the willful non-attendance of a Member’s Management Committee representatives or by a Member’s willful removal and non-replacement of its representatives. If both Managers appointed by a Member fail to attend a meeting (including the first adjournment of a meeting at which business could not be transacted for lack of a quorum) and if adequate notice of the two meetings has been given, Section 5.3(c) provides for an automatic reduction of the quorum at the following meeting. By reducing the quorum requirement to two Managers in such circumstances, Large Member can continue to operate the Company through a validly constituted meeting attended only by its Management Committee representatives despite the efforts of Small Member to frustrate the meeting process. The same, however, does not hold true for Small Member. First, Large Member would not boycott a meeting where

simple majority approval is required because it can obtain such approval through the Chair's tie-breaking vote and, second, neither Large Member nor Small Member need to boycott a meeting requiring supermajority approval under Section 5.4 because they can defeat the matter by attending and simply voting against it.

The use of a four-Manager structure with a quorum requirement set at three means that business may be conducted on behalf of the Company if one of the Managers designated by a Member is unable to be present at a scheduled meeting. In this regard, however, in order to protect its right to control the Management Committee on other than ''supermajority'' matters, Large Member will want to ensure that both of its votes on the Management Committee are represented at each meeting either directly by attendance of its Managers in person or by communication device (Section 5.2(c)) or by delegation in accordance with Section 5.2(f).

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.

Comment

By reason of the tie-breaking vote in Section 5.3(b), in the absence of a default by Large Member, the provisions of Section 5.4 represent, in effect, the fundamental protections for Small Member, other than those indirectly provided by applicable law of fiduciary obligations and Section 5.10 (Duty of Care and Loyalty). As such, these items will be hotly negotiated before signing the joint venture agreement. In this regard, Section 5.4(c), relating to the approval of any new Business Plan or the material modification of an existing plan, will be resisted for inclusion in Section 5.4 by Large Member. Because the Business Plan drives the Company's operating plan, Large Member may not want Small Member to be able to block any new plan or any material modification of an existing plan. On the other hand, the Model JV Agreement contemplates that capital calls will be contained in the Business Plan, and Small Member may wish to have a control on such calls in order to minimize the risk that it will be financially squeezed out of the Company. It may be necessary for the Members to bifurcate this particular provision to meet these conflicting positions. Although the Model JV Agreement describes a process for resolving deadlocks over the Business Plan, which may result in dissolution, the inherent reluctance of either Member to embark on that

process may force them to resolve a Business Plan dispute long before that process is begun.

The negotiations over veto rights will require the parties to balance Large Member's desire to operate the business (in particular if Large Member needs to demonstrate control for purposes of the accounting position Large Member will take regarding consolidation of the joint venture for reporting purposes) and Small Member's desire to protect its legitimate economic interest as the minority noncontrolling joint venturer. Accordingly, lawyers for both parties should consider the extent to which they need to tailor the veto rights to their particular transaction in a manner different from veto rights that may be more ''customary'' for a venture capital, private equity and/or institutional loan transaction. For example, unless related to new lines of business, the veto rights in the Model JV Agreement do not provide a great deal of control to Small Member with regard to day-to-day operational matters that are not directly controlled by the Budget. This means Large Member would be able to exercise control with regard to intellectual property strategy, personnel decisions and terms for customer and supplier contracts. Small Member, particularly if its returns are not guaranteed, might desire to have additional influence over such operational decision making.

Additionally, as the parties negotiate these rights, the parties should be mindful that there are generally six ways to limit the discretion of Large Member with respect to any category of decision making or Small Member with regard to the exercise of veto right. These include (1) an outright veto right over particular types of decision making (this is the approach taken by the Model JV Agreement in Section 5.4) or in the case of Small Member outright restrictions on the ability to exercise the veto right with respect to particular types of decisions to which the veto is generally applicable (for example, Small Member might be prohibited from exercising a veto

right in the context of a transaction in which Small Member has a conflict of interest); (2) a requirement to compensate the other party for the exercise of control or a veto right (for example, if Large Member is permitted to make changes in tax policy, then Small Member might require indemnification for such changes to the extent resulting in a benefit to Large Member but increased taxes to Small Member); (3) an objective limitation on the exercise of control or such veto right (for example, in order for Small Member to be able to exercise a particular veto right, there might be a requirement that the Company have failed to meet some benchmark); (4) a requirement for either third party approval or a third party determination prior to exercise of control or a veto right (for example, in the context of Large Member consummating an acquisition, Large Member might be required to obtain a fairness opinion); (5) a limitation based on a specified standard (for example the imposition of fiduciary duties on the Representatives of Large Member in respect to a particular category of decisions, or in the case of Small Member, a restriction that Small Member's withholding of its consent to any particular action must not be unreasonable), or (6) a requirement that the party exercising control or such veto right follow a certain procedure prior to the exercise of such control or veto right (for example, in the absence of an outright veto right in favor of Small Member, Large Member might be required to wait for a certain time period after initially giving notice of an intent to make a change in tax policy in order to give Small Member time to assess the impact on Small Member of such change prior to the time Small Member is required to present its ''case'' with respect to such change). It should also be noted that the parties might choose to impose several of the above limitations on any one particular area of decision-making and/or veto right.

The introductory clause of Section 5.4 describing the vote that is required in connection with the supermajority issues might initially seem duplicative since,

with four Managers, it would be necessary for at least one Manager from each Member to approve the matter in order for this test to be met. However, the Chair's tie-breaking vote (Section 5.3(b)) would allow Large Member to carry these matters without the addition of the words ''*at least one Manager appointed by each Member.*'' Furthermore, the tie-breaking vote may be exercised only if Large Member is not in default and if it is, Large Member would want the protections of Section 5.4 to act in its interest. Although unlikely, it would also protect Large Member's interest if, for some reason, it had only one Manager present at a meeting and there was no delegation of the absent Manager's vote.

During negotiation of the Section 5.4 items, some of the items described in Section 5.5 (or others) may very well become subject to the supermajority provisions. An example of an item that is not addressed in Section 5.4, and over which Small Member may want a ''veto'' right, is the ability of Large Member to control actions or elections affecting taxes. Section 5.5 items may also come within the control of the Small Member if it becomes entitled to name a third Manager. *See* Section 8.3(c).

Issues surrounding arrangements with Members or Affiliates of Members can be handled as in Section 5.4(i), by requiring consent of both Members, or by setting out standards, such as:

(a) *Standard for Awards*. Unless otherwise provided in this Agreement, if any Member or its Affiliate elects to bid for any contract, the Management Committee may award the contract to the bidding Member or its Affiliate if that bid is in the Company's best economic interest, subject to Section 5.10. The determination of the Management Committee as to the Company's best economic interest will be conclusive.

(b) *Contracts with Members*. By action of the Management Committee,

the Company may enter into contracts with a Member or any of its members, employees, agents, or Affiliates on terms no more favorable than those afforded to unrelated third parties. The validity of any transaction, agreement or payment involving the Company and a Member or its Affiliate will not be affected by reason of the relationship between the Company and the Member, employee, agent or Affiliate of the Member.

Note that antitrust issues can be raised by certain supermajority provisions. For example, provisions giving one or both joint venturers an effective veto over capacity expansions, output levels, etc. could be problematic, especially if the parent companies would compete absent the joint venture but creation of the joint venture itself is allowed because of the efficiencies it produces.

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.

Comment

The primary function of Section 5.5 is to enumerate the specific actions reserved for Management Committee approval, but not requiring the consent of both Members. All other authority is delegated to the CEO under Section 5.6(c). As an alternative to enumerating specific actions, the agreement could reserve to the Management Committee approval of all actions not requiring consent of both Members and not delegated to the CEO. However, the specific enumeration may provide some protection for Small Member since its participation on the Management Committee may be the primary opportunity to be involved in significant business decisions.

5.6 Chief Executive Officer.

(a) *Appointment.* The initial chief executive officer (''CEO'') and subsequent CEOs will be appointed by Large Member. The CEO may be an officer or employee of a Member or its Affiliate.

(b) *Term*. The CEO will hold office until his death, resignation or removal. The CEO may be removed with or without cause by Large Member.

(c) *Authority*. Subject to the power and authority of the Management Committee to revoke or modify the following or to direct the actions of the CEO, the CEO has responsibility and authority for:

(i) operating and managing the day-to-day business and affairs of the Company in a manner consistent with the Business Plan and then-current budgets;

(ii) proposing revisions to the Business Plan or budget for submission to the Management Committee for approval;

(iii) implementing the Business Plan and budget as approved by the Management Committee;

(iv) making any non-material changes to or taking actions that would constitute a non-material deviation from the Business Plan or budget; and

(v) subject to Section 5.1(e)(ii) (Deeds, Certain Promissory Notes, Etc.), executing bonds, mortgages or other contracts or instruments on behalf of the Company.

The CEO will keep the Management Committee reasonably informed of his actions.

Comment

The power of Large Member to appoint the CEO as well as the Chair means that Large Member will have a significant if not pervasive influence over not only the policy matters of the Company but also of its operations. This may initially be appropriate since the Fact Pattern indicates that Small Member does not have the management capability to conduct the Company's business. However, Small Member may wish to provide a different manner of selecting the CEO when the Company's business becomes self-sustaining and the Company can independently function.

Section 5.6(a) specifically permits the CEO to be an officer or employee of a Member

or an Affiliate while serving as CEO of the Company. If Small Member has negotiated for the appointment of a CEO other than by Large Member, as now provided in Section 5.6(a), then it may also wish to provide that the CEO would not be an officer or employee of a Member, at least not without Small Member's consent. Similarly, Small Member may feel that the statement in Section 5.6(b) that the CEO may be removed by Large Member should be deleted.

Section 5.6(c) sets forth the CEO's powers. However, the introduction to that Section permits the Management Committee to override such authority.

5.7 Other Officers and Employees.

(a) *Officers.* The other officers of the Company will include a chief financial officer (the ''CFO''), a Vice President—Marketing, a Vice President—Engineering, a Vice President—Software Development and a Vice President—Administration. The Management Committee will have discretion to appoint other officers and grant them authority to act. An officer may also be an officer or employee of one of the Members or an Affiliate of a Member.

(b) *Appointment*. The initial other officers are as follows:

CFO – _____

VP—Marketing – _____

VP—Engineering – _____

VP—Software Development –_____

VP—Administration – _____

All subsequent appointments of officers will be made by the Management Committee based on the most qualified candidate for the office regardless of whether that individual is or was employed by a Member or any Affiliate.

(c) *Authority.* Each officer has the power and authority set forth in Attachment 5.7(c). Each officer will be subject to the direction of the CEO unless, and to the extent that, the Management Committee directs that he report to it.

(d) *Term.* Each officer will hold office until his death, resignation or removal. Any officer may be removed with or without cause at any time by the CEO or the Management Committee; *provided, however*, an officer subject to appointment by a Member pursuant to Section 5.7(b) may be removed only with the written consent of the appointing Member.

(e) *Employees.* Unless otherwise provided for in the Business Plan, all personnel operating the Business will be employees of the Company.

Comment

Section 5.7(b) provides that the Company will evolve into a free-standing venture choosing its own officers after the initial officers, other than the CEO, have departed. Small Member may not want to relinquish that element of protection because Large Member can control the Management Committee by virtue of the Chair's tie-breaking vote.

Section 5.7(c) provides that the Management Committee may require that an officer be subject to the direction of the Management Committee and not of the CEO. This will be an important policy matter between the Management Committee and the CEO. The inclusion of this language in the Model JV Agreement would tend to indicate a ''strong'' Management Committee and a weaker CEO. Small Member may feel more comfortable with this because it will have input to those other officers by reason of its representation on the Management Committee.

The single sentence in Section 5.7(e) is meant simply to take a position for purposes of the Model JV Agreement. However, at least at inception, this simple arrangement may not be possible to implement. The Company may not have sufficient resources to carry the necessary employees directly.

Perhaps more importantly, however, the persons who would be the initial employees would typically already be employees of either Large Member or Small Member. In the case of those persons who are employed by Large

Member (which continues its separate existence), the employee benefit programs of Large Member are likely to be significantly greater than would be implemented by the Company. The employees of Small Member are likely to have been rewarded for their prior and future performance through stock option programs implemented by Small Member. Although those options could be substituted for the right to receive certain, perhaps non-voting, interests in the Company with, except in the case of Incentive Stock Options, roughly the same tax and financial consequences, a situation in which certain Company employees participate in Large Member type benefit programs while Small Member employees have fewer benefits and greater equity based compensation may not provide for organizational harmony. Accordingly, the Members may wish to ‘‘loan’’ employees to the Company for a period of time (perhaps 3–5 years) after which all of those persons would become employees of the Company and subject to the same benefits and incentive structures.

For discussion of the use of corporate type incentive programs in non-corporate entities, see ‘‘Equity Based Compensation for Companies and LLCs,’’ by John R. Maxfield, Arthur A. Hundhausen and Paul L. Lion, III, a paper presented as part of the program ‘‘The Unincorporation; or, Ms. Doolittle, LLC, Meets H. Higgens, Inc.—Why Can’t an LLC be more like a Corporation,’’ ABA Business Law Section, 1999 Spring Meeting.

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.

Comment

The Model JV Agreement places substantial emphasis on the preparation of a detailed Business Plan that includes budgets. Since material modifications of the initial Business Plan require the approval of both Members under Section 5.4, it is incumbent on the Members to spend sufficient time and effort to examine all

relevant aspects of the Business and mutually agree on the goals for the Company and the anticipated results of its operations. Identification of ‘‘Critical Targets’’ is also highly important because failure to achieve such targets provides the basis for dissolving the Company under Section 7.2(a).

The length of the period covered by the initial Business Plan is a very significant issue and should be addressed carefully, particularly the projections that affect both future budgets and Critical Targets. One alternative may be to consider rolling two or three year budgets for purposes of establishing Critical Targets. Identifying all Critical Targets initially will be exceedingly difficult.

Section 5.4(c) provides that approvals of Business Plans require the consent of representatives of both Members. Even though under Section 5.3(b) Large Member’s appointed Managers effectively exercise control of the Management Committee, the Small Member’s ability to block Business Plans gives the Small Member the power not only to prevent the Large Member from making calls for additional capital contributions by the Small Member, but also to extract control concessions. This is a matter that must be negotiated to protect the respective joint venturers’ interests and to give effect to their intent.

The phrase in Section 5.8(d) allowing adjustments to the last Business Plan reflecting ‘‘other changes in each case that result from the passage of time or the occurrence of events beyond the control of the Company’’ may create ambiguity. However, it does allow needed flexibility to the Company if the Members are not able to agree on one or more proposed modifications in the Business Plan for the next fiscal year.

To the extent the Members require more certainty in the event of a dispute over the Business Plan, the Members might consider agreeing on certain specified adjustments to the Business Plan. For example, increases in certain line items might be linked to a formula. As an example, increases in certain operating expense items might be tied to

the consumer price index (or some other appropriate inflationary measure) and/or percentage adjustments based on actual historical results of operations since, unlike at formation, once the Company begins to operate there will be historical data to rely upon to make such adjustments.

Comment—Complex Target Provisions

Many joint ventures may not have targets that may easily be categorized as Critical and Non-Critical, and the following is not realistic in those instances. However, in complex joint ventures, the following approach may be entirely appropriate and beneficial. It does, however, require modification of Section 5.8(a).

Addition to § 5.8

(e) Certain Targets

(i) Establishment of Targets. The Business Plan sets forth: (A) the targets for the manufacturing of the Initial Products and New Products (the ‘‘Production Targets’’); and (B) the targets for sales, operating profits and net profits for the Company (the ‘‘Economic Targets’’). ‘‘Targets’’ means any or all of Production Targets, Economic Targets, Critical Targets and Non-Critical Targets. A ‘‘Critical Target’’ is a Production Target or an Economic Target specified in the Business Plan by the Members as a Critical Target. A ‘‘NonCritical Target’’ means any Target that is not a Critical Target. ‘‘NonCritical Target Failure’’ means any failure to meet a Target that is a Non-Critical Target.

(ii) Non-Critical Target. If any Non-Critical Target Failure occurs, then: (A) the Management Committee will address that NonCritical Target Failure, including considering a plan of action to remedy that Non-Critical Target Failure and/or to prevent the occurrence of similar Non-Critical Target Failures in the future, which plan of action may include changes in the Company’s management personnel, decreases or increases in the number of Company employees, increases or decreases in the level of various Company expenditures or revisions in the Company’s

marketing program and/or marketing strategies; and (B) the Management Committee will use its Best Efforts to agree upon and implement the a plan of action.

(iii) Critical Target Failure.

(A) Definition. Each of the following will constitute a ‘‘Critical Target Failure,’’ but only if it does not constitute a Fundamental Company Failure:

(1) the failure to satisfy any Critical Target, unless the Members agree in writing within 30 days after the occurrence of that failure not to treat that failure as a Critical Target Failure; or

(2) the occurrence of any [three] Non-Critical Target Failures, which may be all of one type, such as Production Targets, or a combination of various types of Targets, within any period of [six] months, unless the Members agree in writing within 30 days after the occurrence of the [third] Non-Critical Target Failure not to treat the occurrence of the Non-Critical Target Failures as a Critical Target Failure.

(B) Resolution. If any Critical Target Failure occurs, then: (a) the Management Committee will address that Critical Target Failure, including considering a plan of action to remedy that Critical Target Failure and/or to prevent the occurrence of similar Critical Target Failures in the future, which plan of action may include changes in the Company’s management personnel, decreases or increases in the number of Company employees, increases or decreases in the level of various Company expenditures or revisions in the Company’s marketing program and/or marketing strategies; and (b) the Management Committee will use its Best Efforts to agree upon and implement that plan of action.

(iv) Fundamental Company Failure. A ‘‘Fundamental Company Failure’’ means the occurrence of any event that could reasonably be expected to prevent the Company from achieving its fundamental business objectives and that cannot

reasonably be expected to be corrected within a reasonable time and at reasonable expense. Upon the occurrence of a Fundamental Company Failure, the Members will dissolve the Company, and the dissolution will be effected as though one Member had given notice to the other Member dissolving the Company pursuant to Section 7.2.1, unless the Members agree in writing upon an alternative course of action within 60 days after the occurrence of the Fundamental Company Failure.

5.9 Dispute Resolution Procedures.

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

Comment

Section 5.9 provides a method for bringing a dispute before escalating levels of authority within a business enterprise who are sufficiently removed from the Management Committee so that they may not be affected by any personal dynamics that may interfere with a resolution. The Section also provides time for sober second thought, yet not so much time as to put at risk the value of the enterprise.

The number of levels of authority to be employed and the time allotted for each, and the specificity of the constraints of negotiation imposed on each depends, of course, on the facts of each case. However, in every case, at least two factors should be considered in determining the number of levels of escalating authority (if any) that are appropriate: first, how long a joint venture enterprise is likely to be able to endure while the dispute resolution process continues, and second, whether the procedure is likely to be successful given the corporate structure and culture of each Member.

In some cases, the last level of appeal in the process could be to the board of directors of each Member. That kind of provision is more likely to be effective, if at all, not because boards of directors are likely to enter into negotiations with each other to resolve disputes, but rather because few chief executive officers will be willing to

allow a dispute to be referred to that forum and, therefore, will be under great pressure to reach a resolution before that can occur. In large companies that pressure point may exist several levels below a chief executive officer. In smaller companies without an elaborate reporting chain of command, it may be practical to refer a dispute directly from the Management Committee to the chief executive officer. If the Members are corporations of unequal size (as in the case of the Fact Pattern), then care should be taken to escalate any dispute to the same levels of decision-making power rather than to persons with the same titles.

5.10 Standard of Conduct.

(a) *Generally*. A Manager and each Officer, in managing the business or affairs of the Company, will discharge his duties:

(i) in a manner he believes in good faith to be in the best interests of the Company;

(ii) in a manner he believes in good faith to represent the care an ordinarily prudent person in a like position would exercise under similar circumstances;

(iii) in good faith reliance on the provisions of this Agreement;

(iv) without intentional misconduct or a knowing violation of law; and

(v) without engaging in any transaction for which he receives a personal benefit in violation or breach of any provision of this Agreement.

Except for the implied contractual covenant of good faith and fair dealing under applicable Delaware law, no Manager or Officer has any other duty to the Company, any Member or any other Person.

(b) Limitations. Notwithstanding the foregoing Subsection (a), a Manager or Officer (i) does not violate a duty or obligation under this Agreement or under Applicable Law because the Manager's or Officer's conduct furthers the interest of a Member (including in the case of a Manager, the Member that designated the Manager, the Members each acknowledging that each Member has appointed a Manager with the expectation that such

Manager will represent and serve the interest of the Member appointing him) and (ii) without limiting the foregoing clause (i), has no duty or obligation to consider any interest of or affecting the Company, any Member or any other Person.

(c) *No Duty of Members*. No Member has any duty to the Company or any Member solely by reason of acting in its capacity as a Member, except to refrain from (i) any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing and (ii) any transaction in which the Member receives a personal benefit in violation or breach of any provision of this Agreement. Thus, without limiting the foregoing, a Member (A) does not violate any duty or obligation under this Agreement or under Applicable Law because the Member's conduct furthers its interest and (B) has no duty or obligation to consider any interest of or effect on the Company or any other Person.

(d) *Override*. The provisions of this Agreement (including this Section 5.10 and Sections 5.11 and 5.12) replace, eliminate and otherwise supplant those duties (including fiduciary duties) that a Member, Manager or Officer might otherwise have under Applicable Law.

Comment

Although the DLLCA does not specify the duties of managers and officers of a limited liability company, recent Delaware cases have imposed fiduciary duties on managers of limited liability companies. *See VGS, Inc. v. Castiel*, No. C.A. 17995, 2000 WL 1277372 at *4 (Del. Ch. Aug. 31, 2000), *aff'd*, 781 A.2d 696 (Del. 2001) (managers of a manager-managed limited liability company owe a duty of loyalty to the limited liability company, its members and their fellow managers). However, the *Castiel* case was decided before the DLLCA was amended in 2004 to permit the ''elimination'' (as opposed to merely the ''limitation'') by a limited liability company agreement of fiduciary duties, so it is doubtful whether those cases will have any continuing force in light of the amended statute.

As amended in 2004, DLLCA § 18–1101(c) provides:

> To the extent that, at law or in equity, a member or manager or other person has duties (including fiduciary duties) to a limited liability company or to another member or manager or to another person that is a party to or is otherwise bound by a limited liability company agreement, the member's or manager's or other person's duties may be expanded or restricted or eliminated by provisions in the limited liability company agreement; provided, that the limited liability company agreement may not eliminate the implied contractual covenant of good faith and fair dealing.

The reference in the last sentence of § 5.10(a) to the ''implied contractual covenant of good faith and fair dealing'' tracks the language of DLLCA § 18–1101(c). Under Delaware law, ''an implied covenant of good faith and fair dealing is engrafted upon every contract.'' *Wilgus v. Salt Pond Inv. Co.*, 498 A.2d 151, 159 (Del. Ch. 1985); *Restatement (Second) of Contracts* § 205 (1981); Del. Code Ann. tit. 6, § 1–304 (effective Jan. 1, 2005) (Del. UCC provision). A discussion of the implied contractual covenant of good faith and fair dealing is beyond the scope of this Model JV Agreement, but for a general discussion, *see* Paul M. Altman and Raju M. Srinivas, *Delaware Alternative Entities and the Implied Contractual Covenant of Good Faith and Fair Dealing Under Delaware Law*, 60 *THE BUSINESS LAWYER.* 1469 (August 2005).

Although DLLCA permits a limited liability company agreement to eliminate fiduciary duties (other than the implied contractual covenant of good faith and fair dealing), both joint venturers presumably will want each of the Managers and Officers of the joint venture to be subject to some minimal standards of conduct, the violation of which would permit the Company or either joint venturer to enjoin the violative conduct. Because Large Member is able to control most Company actions

through the Chair's tie-breaking vote, Small Member may assert that Section 5.10 should impose greater duties on the Managers. However, Large Member arguably has the same interest as Small Member with regard to many decisions involving the Company (*e.g.*, negotiating the terms of a loan with a third party or the terms of a distribution agreement with a company that is not affiliated with Large Member), so Large Member may claim that the imposition of fiduciary duties on its representatives in respect of those decisions is not necessary and unduly exposes Large Member to liability. Because of this, Large Member may argue that, if Small Member has a particular concern regarding an action that can be taken by the Management Committee, that concern be addressed by adding the action to the list of the ''major'' actions in Section 5.4 that require the approval of at least one Manager appointed by each Member.

Based on the assumption that the joint venturers will want some minimal standards of conduct imposed on the Managers and Officers, the Model JV Agreement contains the fairly customary fiduciary duties of loyalty (clause (i)) and care (clause (ii)), as well as the duty to act without intentional misconduct or a knowing violation of law (clause (iv)). The duties in clause (iii) are based on the provisions of DLLCA § 18–1101(d) that limit liability of managers and officers for breach of fiduciary duty for their good faith reliance on the provisions of a limited liability company agreement. Finally, the duties in clause (v) correspond to the requirement in § 5.4 for supermajority approval of transactions between the joint venture and its Managers.

The last sentence of § 5.10(a) is to make clear that the provisions of this Agreement are intended to replace and modify any duties (including fiduciary duties) that a Member, Manager or Officer might otherwise have under law. *See Miller v. American Real Estate Partners, L.P.*, No. Civ. A. 16788 2001 WL 1045643 at *8 (Del. Ch. Sept. 6, 2001) (decided under the analogous provision of § 17– 1101(d) of

the Delaware Revised Uniform Limited Partnership Act; court stated that the drafter of a partnership agreement must use due care to ‘‘supplant the operation of traditional fiduciary duties’’).

Note that Section 5.10(a) applies the same standards to Managers and Officers. It may be that different standards should apply to Officers—and more specifically that subsection (a) ought to be replaced with two subsections, one for Managers and one for Officers.

5.11 Managers and Officers—Exculpation. No Manager or Officer will be personally liable to the Company, any Member or any other Person for monetary damages for any act or omission, including breach of contract or breach of duties (including fiduciary duties) of a Manager or Officer to the Company, any Member or any other Person, except (a) for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing or (b) for any transaction for which the Manager or Officer received a personal benefit in violation or breach of any provision of this Agreement.

Comment

Section 5.11 is based on DLLCA § 18–1101(e) and limits the personal liability of Managers and Officers for monetary damages.

The exception in § 5.11(a) is based on DLLCA § 18–1101(e), which prohibits exculpation for ‘‘any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing.’’ The exception in § 5.11(b) corresponds to the requirement in § 5.4 for supermajority approval of transactions between the joint venture and its Managers.

Note that the exceptions in § 5.11 are narrower than the general standards of conduct of Managers and Officers in § 5.10. As noted in the comment to § 5.10, it is likely that the joint venturers will want the Company’s Managers and Officers to be subject to some minimal standards of conduct, the breach of which may be enjoined by the

Company or either joint venturer but should not subject the Manager or Officer to personal liability.

The authors of the Model JV Agreement believe that the language in § 5.11 is broad enough to reflect the provisions of DLLCA § 18– 1101(d) that limit liability of managers and officers for breaches of fiduciary duty for their good faith reliance on the provisions of a limited liability company agreement. If the provisions of DLLCA § 18–1101(d) had been stated expressly in § 5.11, such would seem to add an unintended limitation to § 5.11—specifically that the Manager or Officer could be denied exculpation if he had not relied in good faith on the provisions of the limited liability company agreement, even though he did not violate clauses (a) or (b) of Section 5.11.

5.12 Managers and Officers—Indemnification.

(a) *Generally*. The Company will indemnify, defend and hold harmless each Manager and Officer (each, a ''Company Indemnified Person'') in connection with the management of the Company or any entity in which the Company has an interest to the fullest extent permitted under the DLLCA and applicable law; *provided, however*, that the foregoing obligations will not apply to the extent that the act or omission of the Company Indemnified Person involved either (i) any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing or (ii) any transaction for which the Company Indemnified Person received a personal benefit in violation or breach of any provision of this Agreement.

(b) *Procedure.* If indemnification is requested by a Company Indemnified Person, the Management Committee will cause a determination to be made as to whether indemnification of the Company Indemnified Person is proper in the circumstances. Upon any such determination that indemnification is proper, the Company will make indemnification payments of liability, cost, payment or expense asserted against, or paid or incurred by, the Company Indemnified Person to the

maximum extent permitted by the DLLCA and applicable law.

(c) *Defense Counsel*. The Company will have the right (i) to approve any counsel selected by any Company Indemnified Person and (ii) to approve the terms of any proposed settlement. Such approvals will not be unreasonably withheld or delayed.

(d) *Expenses*. The Company will advance to any Company Indemnified Person reasonable attorneys' fees and other costs and expenses incurred in connection with the defense of any proceeding if the Company Indemnified Person agrees in writing before any advancement that he will reimburse the Company for such fees, costs and expenses to the extent that the Management Committee determines that he was not entitled to indemnification under this Section.

(e) *Non-Exclusive*. The rights accruing to each Company Indemnified Person under this Section will not exclude any other right to which he may be lawfully entitled.

(f) *Subsequent Amendment*. If the DLLCA is hereafter amended to eliminate or limit the personal liability of managers or officers, then the liability of a Manager or Officer shall be eliminated or limited to the fullest extent permitted by the DLLCA, as so amended. No amendment, termination or other elimination of this Section or of any relevant provisions of the DLLCA or of any other applicable law will affect or diminish in any way the rights to indemnification under this Section with respect to any action, suit or proceeding arising out of, or relating to, any event or act or omission occurring or fact or circumstance existing before the amendment, termination or other elimination.

(g) *Continuation of Right to Indemnification*. All rights to indemnification under this Section will continue as to a person who has ceased to be a Manager or Officer, will inure to the benefit of the heirs, executors, administrators and the estate of that person, and will be deemed to be a contract between the Company and each such person. This Section shall be binding upon any successor to the Company,

whether by way of merger, consolidation, liquidation, dissolution or otherwise.

(h) *Savings Clause*. If this Section or any portion of it is invalidated on any ground by any court of competent jurisdiction, then the Company will nevertheless indemnify persons specified in this Section to the full extent permitted by any applicable portion of this Section that has not been invalidated and to the full extent permitted by applicable law.

Comment

Section 5.12 sets forth the Company's indemnification obligations to the Managers and Officers in connection with their acts and omissions involving the joint venture.

DLLCA § 18–108 permits indemnification of ''any member or manager or other person,'' but does not specify any exceptions to such indemnification. The proviso in Section 5.12(a) is based on DLLCA § 18–1101(e) and the limitations on transactions between the joint venture and its Managers in Section 5.4 and reflects the exceptions to the exculpatory provisions of Model JV Agreement § 5.11. See DLLCA § 18–406 regarding reliance on reports and information by managers.

The remaining provisions reflect generally standard practice in corporate indemnification as to the Company's rights, as the indemnifying party, to approve lawyers and settlement terms. They also reflect generally standard practice in corporate indemnification providing protections to the Managers and Officers against adverse changes in the Company's indemnification obligations from those under which they agreed to hold such positions.

Each drafter should also consider discussing with his client what insurance coverage for the Company ought to be purchased and whether it might be provided as part of the insurance program of Large Member. Depending on the outcome of these discussions, it might be appropriate to include in the joint

venture agreement provisions allocating to the Company a proportional share of Large Member's insurance premiums, casualty loss funding pools and related expenses.

Article 6: Transfer Restrictions on Member Interests

General Comment

It is a fundamental aspect of a joint venture that the Members choose each other for the capabilities that each believes that the other brings to the enterprise and for intangible reasons, most critically the ability to work together in resolving inevitable differences. It is important then that each Member be protected against having its chosen co-venturer replaced by a person who does not have the qualities of its original co-venturer, and who in fact may have negative qualities, such as being a competitor. This concern must be balanced against the fact that in the context of an operating company, in particular Large Member, this joint venture is only one aspect of its business. Accordingly, each Member will want to make sure that the transfer restrictions do not give the other Member an unreasonable right to delay or otherwise affect the Member's ability to incur indebtedness for its other operations or to consummate a transaction resulting in a change of control or a sale of all or substantially all of the assets of such Member. In addition, the parties should carefully consider whether the transfer restrictions that apply to situations where transactions are limited to the interest in the joint venture should also apply to transfers that are effected in the context of a larger corporate transaction involving all or substantially all of a Member's assets. On the other hand, if the transaction involves a competitor, the same issues exist.

Section 6.1, which is discussed in greater detail below, gives this basic protection by prohibiting the transfer of a Member Interest except as otherwise specifically permitted or required by other sections of the Model JV Agreement.

Section 6.1 thus gives the ‘‘general’’ rule to which those other sections are exceptions, and against the background of which they should be read. Sections of the Model JV Agreement that permit transfers of a Member Interest include Section 6.2 (Assignment to Controlled Persons). Required transfer of a Member Interest is covered in Sections 8.3(a)(ii) (Right To Buy) and 8.3(a)(iii) (Right To Sell). Sections that both permit and require transfers include Section 3.3(b) (Loan By Other Member) and Section 10.1 (Offer to Buy or Sell). The following discussion also considers some of the statutory restraints that can limit or make ineffective the general rule of Section 6.1.

Section 6.2, an exception to Section 6.1, permits transfers to assignees in the same chain of control.

The Model JV Agreement does not contain a provision for allowable transfers outside of controlled entities to persons who meet certain criteria. While financial tests could be set forth and a restriction against transfers to a competitor could be included, as noted in the introductory paragraph above, many of the reasons that a venturer would, or would not, consent to a transfer are highly subjective and cannot be realistically defined. In addition, a venturer may object to a ‘‘consent not unreasonably withheld’’ standard since such a provision would raise a presumption that the Members would allow ‘‘reasonable’’ assignments, and the Model JV Agreement is not intended to do that.

As discussed below, in some jurisdictions (but not, for example, Delaware) the characterization by Section 2.10 of the Member Interests as securities within the meaning of UCC Article 8 may be critical in the enforceability of these transfer restrictions.

6.1 Restrictions on Transfer of Member Interests. Except to the extent specifically permitted or required by this Agreement, neither Member may transfer its Member Interest or any interest in it. For purposes of this Article, ‘‘transfer’’ and its derivatives include all

forms of direct or indirect transfer or disposition, voluntary or involuntary, by operation of law or otherwise, as well as the creation of any Encumbrance on all or any part of a Member Interest. The provisions of this Article 6 replace, eliminate and otherwise supplant any contrary provisions in the DLLCA (including DLLCA § 18–702) that permit the assignment of a limited liability company interest.

Comment

Section 6.1 states the general prohibition against transfers. As provided in Section 6.3, a Member's violation of this prohibition makes the Member a ''Defaulting Member'' under Section 8.2(f), which entitles the Non-Defaulting Member to the remedies in Article 8. In fact, Section 8.2(f) could be triggered earlier, since it provides that a Member's merely ''agreeing'' to a transfer prohibited by Section 6.1 makes that Member a ''Defaulting Member.''

Section 6.1 broadly defines ''transfer''—the operative word for Article 6—as being all forms of transfers of any interest, including the creation of an ''Encumbrance,'' which in turn is defined in Attachment 1.1 to the Model JV Agreement (Definitions and Certain Rules of Construction). This definition of ''transfer'' avoids the litany of various kinds of transfers one sometimes sees (such as ''transfer, assign, sell, dispose, bequeath or give'') on the basis that all are encompassed within the phrase ''.... all forms of direct or indirect transfer or disposition.'' However, the added language ''voluntary or involuntary, by operation of law or otherwise'' is advisable and may be necessary. Some courts, for example, have held that a general restriction on transfers does not apply to involuntary transfers unless it explicitly states that it does. *See Rouse & Assocs., Inc. v. Delp*, 658 A.2d 1383 (Pa. Super. Ct. 1995); *Bryan-Barber Realty, Inc. v. Fryar*, 461 S.E.2d 29 (N.C. Ct. App. 1995). Other courts have held that, unless clearly stated, a restriction may not apply to a transfer by operation of law, such as in a merger. *See Star Cellular Tel. Co. v. Baton Rouge CGSA, Inc.*, Civ. A.

No. 12507, 1993 WL 294847 at *11 (Del. Ch. July 30, 1993). The drafter should consider any similar precedent in the relevant jurisdiction.

However, the drafter needs to carefully consider the extent to which applicable law will allow the Company and the other Member to recognize Section 6.1's general prohibition against transfers (which is further underscored by Section 6.3).

DLLCA § 18–702(a), for example, provides that a ''limited liability company interest'' is assignable ''except as provided in a limited liability company agreement''—which is reflected in the second sentence of Section 6.1. DLLCA § 18–101(8) defines a ''limited liability company interest'' as a member's share of profits and losses and a member's right to receive distributions. DLLCA § 18– 702(b), while providing that the assignment of a limited liability company interest does not entitle the assignee to exercise any rights or powers of a member, does confer other rights on the assignee. It confers, of course, the right to profits and losses, distributions and allocations of income, gain and loss to which the assignor was entitled.

However, while the DLLCA permits the assignment of a limited liability company interest and confers the rights described above, a limited liability company agreement can override most of those provisions pursuant to DLLCA § 18–702(a), and that is what Article 6 of the Model JV Agreement is intended to do. *See also*, DLLCA § 18–603 (''[n]otwithstanding anything to the contrary under applicable law, a limited liability company agreement may provide that a limited liability company interest may not be assigned prior to the dissolution and winding up of the limited liability company''). Section 6.3 (as discussed below) overrides provisions allowing the transfer of a limited liability company interest, even though the rights attendant to an assignee of a limited liability company interest may be limited. The Model JV Agreement takes this position on the basis that any alienation of any interest in the

Company, however slight, might lessen the assigning member's interest in, or commitment to, the Company. If a member does not expect to keep limited liability company distributions, how enthusiastically will it perform its obligations under the Model JV Agreement, or devote the time, attention and resources to make the joint venture prosper?

In addition to Article 6's overriding of DLLCA § 18–702 by including contrary provisions in the Model JV Agreement, both the non-transferable legend on the cover page of the Model JV Agreement, and the legend required on certificates by Section 2.10 put prospective assignees on notice that there are restrictions on assignments in the agreement.

But even if the Model JV Agreement incorporates the foregoing as to restrictions on transfers, the effect of other state statutes (including the Uniform Commercial Code (''UCC'') in those other states), case law and the Bankruptcy Code must still be taken into account. The first of those other laws to be considered is the UCC.

The Model JV Agreement specifies in Section 2.10 that the Member Interests will be treated as securities for purposes of UCC Article 8 and that the Member Interests will be evidenced by certificates. This is in response to 1999 revisions to UCC Article 9 that contained a number of relevant provisions, many of them for the first time in the history of the UCC. Among these are the definitions of a ''general intangible'' (generally considered to include a limited liability company interest) and a ''payment intangible.'' The latter is a subset of the category of general intangibles in which an account debtor's principal obligation is monetary. (In UCC parlance, a limited liability company agreement is one between an ''account debtor,'' i.e., the limited liability company from which a member receives money—and against which it may have other rights— and a ''creditor,'' i.e., a member entitled to receive that money and that may wish to sell that right or, in the capacity of a ''debtor'' to another, to pledge that right as security.) Thus, if a general intangible encompasses the full scope

of a member's interest in a limited liability company, the subset that includes only the right to receive payments (i.e., a ''payment intangible'') appears to correspond to the notion of a ''limited liability company interest'' in a limited liability company under the DLLCA discussed above. The UCC also treats differently the sale of such rights (an ''absolute assignment'') on the one hand, and the giving of such rights as collateral security for an obligation on the other hand, even though both conceptually involve the creation of a ''security interest'' under the UCC.

UCC § 9–406(d) declares ineffective any provision in an agreement (e.g., in a limited liability company agreement) that prohibits, restricts or requires consent for, the creation, attachment, perfection or enforcement of a security interest in a payment intangible. However, UCC § 9–406(d) applies only to a security interest in a payment intangible that arises because it secures an obligation and not to a security interest arising from an outright sale of a payment intangible. The definition of ''transfer'' in Section 6.1 includes the creation of an ''Encumbrance,'' so that Section 6.1 prohibits the creation of a security interest in a Member Interest. To the extent that such a security interest arises from the giving of collateral, UCC § 9–406(d) renders Section 6.1 ineffective.

In addition, UCC § 9–408 similarly renders ineffective provisions in agreements and under statutes that prohibit transfers of the broader category of general intangibles (other than the subset of payment intangibles arising on account of the grant of a security interest as collateral that is covered under UCC § 9–406). However, unlike UCC § 9–406, UCC § 9–408 provides that it, and the ineffectiveness it prescribes for clauses restricting the assignment of general intangibles, are not enforceable against, and impose no duty on, an account debtor (e.g., a limited liability company).

It should be borne in mind that the 1999 revisions to Article 9 were drafted broadly to encompass a broad range of cases. For example, the examples given in the commentary to UCC §§ 9– 406 and 9–408 range from the assignment of the right to

payment under a contract for the manufacture of goods to rights arising under software licenses. It remains to be seen exactly how the courts may apply to limited liability companies and limited liability company interests the categories and structures that appeared for the first time in the 1999 revision of UCC Article 9. It seems clear, however, that UCC Article 9 makes ineffective as to all persons a provision in a limited liability company agreement (such as Section 6.1) that prohibits the creation of a security interest in the right to limited liability company distributions—at least to the extent that a security interest has been given to provide collateral security. It appears that such a provision restricting outright sales of a limited liability company interest is also made ineffective as to all persons other than the limited liability company, thereby allowing a limited liability company to deny to an assignee a participation in management rights that the DLLCA also denies.

Although the purpose of UCC § 9–406 appears to be limited to allowing a member to grant a security interest in its distributions from a limited liability company as collateral, even that freedom may give the other member and its lawyers some concern by allowing the granting member to divorce its economic interest in the limited liability company from its management rights. The DLLCA permits the limited liability company agreement to restrict that right of transfer by overriding contrary provisions of the DLLCA.

As noted, Section 2.10 attempts to avoid the applicability of UCC §§ 9–406 and 9–408 by making a Member Interest a ‘‘security’’ under UCC Article 8. UCC Article 9 applies to ‘‘general intangibles’’ and not to ‘‘investment securities,’’ which are governed by UCC Article 8. UCC § 8–103(c) provides that an interest in a partnership is a security if ‘‘. . . its terms expressly provide that it is a security governed by this Article [8]....’’The drafter who includes a provision in a limited liability company agreement stating that a limited liability company interest is a security under UCC Article 8 should also consider whether other steps are necessary or appropriate to give

a limited liability company interest all of the attributes of a certificated security under UCC Article 8. This approach also provides a clear way to give third parties notice of all restrictions on transfers by putting a conspicuous legend to that effect in the limited liability company agreement or in any certificate that is issued to evidence a limited liability company interest.

In considering whether or how to deal with these UCC issues, the drafter should, of course, consider the specific text of the limited liability company act and the Uniform Commercial Code that has been enacted in the relevant jurisdiction. For example, Delaware amended the DLLCA to exclude interests in a limited liability company from application of UCC §§ 9–406 and 9–408 without regard to any declaration in the limited liability company agreement that they are ‘‘securities’’ under UCC Article 8. Thus a limited liability company governed by the laws of Delaware can restrict alienability of limited liability company interests to the fullest extent permitted by the DLLCA without regard to the limitations on that ability imposed by the UCC. The issue of whether the Delaware UCC applies to transfers in a jurisdiction that has not similarly amended its UCC raises issues beyond the scope of this comment—but the careful drafter would presumably include the language characterizing the intent in a Delaware limited liability company as a security to forestall such agreements.

Even if UCC § 9–406 continues to apply and make unenforceable a prohibition against the grant of a security interest for collateral, the drafter should note that Section 17.8 (Severability) should preserve the enforceability of all other aspects of Section 6.1, and therefore make it unnecessary to amend the concluding phrase of Section 6.1 to read: ‘‘. . . as well as the creation of any Encumbrance, *to the extent permitted by law*, on all or any part of a Member Interest.’’

Finally, one must bear in mind two further unavoidable limitations on clauses restricting assignment of a member’s limited liability company interest.

The first of these arises under the DLLCA itself. DLLCA § 18–703(a) provides that

on application of a judgment creditor of a member, a court may charge the ‘‘limited liability company interest’’ (as defined by the DLLCA) of the member/judgment debtor to satisfy the judgment. DLLCA § 18–703(b) states that such a charging order constitutes a lien on the judgment debtor’s limited liability company interest. This is not surprising since members have no legitimate expectation that their arrangements should preempt the judicial process. What is interesting, though, is that DLLCA § 18–703(a) is not listed among those DLLCA provisions that cannot be varied by the limited liability company agreement. Therefore it appears that the members could waive this method of enforcing judgments among themselves, but could not thereby affect the rights of third parties.

The second such unavoidable limitation arises under the Bankruptcy Code. Under Bankruptcy Code 541(c), for example, a debtor’s bankruptcy estate automatically succeeds to the debtor’s property, which includes a member’s financial rights and may include some management rights. See, for example, *In re Jacqueline Smith*, 185 B.R. 285 (Bankr. S.D. Ill. 1995) with respect to the right to apply for judicial dissolution.

6.2 Assignment to Controlled Persons. Each Member may, from time to time, transfer all of its Member Interest to a Person controlling, controlled by or under common control with, that Member (and for this purpose ‘‘control’’ means the direct or indirect beneficial and record ownership of all of the economic and voting interests in the transferee), but only if at the time of the transfer:

(a) the transferee agrees in a writing delivered to the other Member and the Company that it will be bound in all respects by this Agreement; and

(b) the transferor guarantees in a writing delivered to the other Member and the Company the performance by the transferee of all of its obligations under this Agreement.

Effective with the delivery of such written undertakings, the transferee will succeed to all

of the transferor's rights and obligations other than the transferor's obligations under Section 6.2(b).

Comment

Section 6.2 allows each Member to transfer its Member Interest to other 100% owned and controlled members of its controlled group. A Member can, therefore, engage in internal reorganizations of business structure without having to ask the other Member for permission. Generally this should be acceptable to the other Member. Section 6.2 permits transfers to a ''person controlling, controlled by or under common control with, such Member'' rather than to an ''Affiliate'' because the latter term, which is defined in Model JV Agreement Attachment 1.1, includes individuals such as officers and directors to whom such permissible transfers are obviously not intended.

Note the possibility of an attempted ''end run'' around the general prohibition against transfer in Section 6.1, by a Member first transferring its Member Interest to a wholly owned subsidiary as permitted by Section 6.2, and then selling all the shares of that subsidiary to another person. Such an attempt would be frustrated by Section 6.1, which prohibits all forms of indirect transfer. Section 8.2(g) (Change of Control) reinforces this prohibition. However, if a joint venture agreement did not contain such a change of control provision or if it were deemed inadequate to prevent such ''end runs,'' the problem could be addressed in Article 6 by adding the following third requirement for a permitted transfer to a member of a controlled group:

(c) the transferor and the transferee agree in writing that, at any time that the transferor ceases to be the direct or indirect beneficial and record owner of all of the economic and voting interests in the transferee, the Member Interest and all rights then appertaining to such Member Interest of the transferee will immediately revert to, and become solely the Member

Interest and appurtenant rights of, the transferor and each of them will then do and cause to be done all things necessary to cause the reversion to be legally effective for all purposes, and the written agreement will name the other Member as a third party beneficiary.

6.3 Effect of Non-compliance.

(a) *Non-Permitted Transfers Null and Void*. In addition to creating rights under Section 8.2(f) (Default Event—Prohibited Transfer), **ANY ATTEMPTED TRANSFER NOT STRICTLY IN ACCORDANCE WITH THE PROVISIONS OF THIS ARTICLE WILL BE VOID AB INITIO AND OF NO FORCE OR EFFECT WHATSOEVER.**

(b) *Other*. Without limiting the foregoing, if any Member Interest or certificate representing it is purported to be transferred in whole or in part in contravention of this Article, the Person to whom the transfer is made will not be entitled to any rights as a Member, including any rights:

(i) to participate in the management, business or affairs of the Company,

(ii) to access to information concerning Company transactions,

(iii)to inspect or copy the Company's books or records,

(iv)to receive distributions to which the transferor would otherwise be entitled, or

(v) to receive upon the dissolution and winding up of the Company the net amount otherwise distributable to the transferor.

Comment

Section 6.3(a) supports Section 6.1's general prohibition of transfers by making it clear that any non-permitted transfer is void. Section 6.3(b) lists the rights denied to a non-permitted transferee. Sections 6.3(b)(i) through 6.3(b)(ii) restate DLLCA § 18–702, which lists rights of participation in the limited liability company that are denied to an assignee of a ''limited liability company

interest.'' Sections 6.3(b)(iv) and 6.3(b)(v), consistent with DLLCA § 18–702(b), negate those rights to distributions that DLLCA otherwise gives to the assignee of a ''limited liability company interest'' but that DLLCA § 18–702(b) allows a limited liability company agreement to change. Again, the drafter should consider whether this list is compatible with the UCC and other laws described above.

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

General Comment

Article 7 and Article 8 define the Members' exit rights, either by dissolution or by purchase or sale of Member Interests. Article 7 addresses these exit rights in the absence of default, and Article 8 addresses these exit rights if a ''Default Event'' has occurred. Article 9, Article 10 and Article 11 implement the exercise of those rights.

In the context of a limited liability company whose purpose is to establish and operate a particular business as a joint venture, it is worth asking whether there should be any exit or termination provisions. Having exit or termination provisions may seem to be contrary to the purpose of the Company and, at the time of negotiating the joint venture agreement, the need for having any such provisions may appear remote. Even if it is acknowledged that the Company may not succeed, the circumstances of its failure will be impossible to predict at the outset, and it may be argued that reasonable Members will be better able to negotiate a satisfactory termination when they know the particular circumstances. Moreover, having this uncertainty as to whether or how a Member could exit or terminate a joint venture has the advantage of tending to keep the Members together.

If one Member is clearly financially or otherwise stronger than the other, the stronger Member may be inclined to resist having any exit or termination provisions, preferring to rely upon its likely stronger negotiating position at the time when any termination or exit is proposed. Obviously, the weaker Member would prefer to

negotiate exit and termination provisions at the outset in the spirit of mutual co-operation and enthusiasm for the new venture. Often the stronger Member will agree in order to achieve the greater certainty that results from having specific exit and termination provisions.

Whether or not there are contractual provisions regarding exit or termination rights and obligations, applicable law imposes standards of conduct and perhaps additional duties. There may also be competition law issues, employment law issues, confidentiality issues and issues surrounding ownership of various physical and intellectual property rights. Dealing with those issues in the joint venture agreement not only reduces uncertainty but also enables the Members to draft their own rules in ways that may differ from the application of relevant laws in the absence of contractual provisions. Even with the utmost good will, unraveling the complex mix of people and assets and ideas that formed the Company generally suggests trying to include some basic rules to make the process more efficient and less contentious.

If the Members decide to have exit or termination provisions, it is necessary to consider, first, what are appropriate triggering events and, second, what type of exit and termination provisions are appropriate for various triggering events. Events that may trigger exit or termination rights and obligations are generally considered to be of two kinds—those that arise because of a default (or similar event) by a Member and those that do not. The latter may include: (1) events that reflect a frustration of the business intent such as the failure to achieve targets; (2) management deadlocks; (3) third party offers for the interests of one or both of the Members; or (4) a change in business strategy or personnel of one of the joint venturers that has the effect of that Member wanting to liquidate its interest in the Company. Other events may arise through a default by one of the Members of its obligations under the joint venture agreement or by the occurrence of specified events, such as a change of control of a Member.

In the case of both a non-default event and a default by one of the Members, the usual remedies are dissolution of the Company or a buy-out of the defaulting Member's interest by the non-defaulting Member. Who may chose the applicable remedy, and the way in which that remedy is accomplished, depends on whether or not a default or similar event has occurred.

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).

Comment

This Article applies only to non-default events. Article 8 applies to default events.

If a non-default event occurs, the Company may be dissolved by either Member pursuant to Article 9 (Dissolution Procedures) or pursuant to Article 10 (Buy-Sell In The Absence of Default).

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:

Comment

The first relevant consideration in drafting termination provisions in a joint venture agreement is whether the termination is to occur as a consequence of the act of one of the Members or whether the event giving rise to the termination is beyond the control of the Members. The underlying purpose is generally to distinguish those events that essentially reflect a ''no-fault'' circumstance when each of the Members should be treated equally from those in which the circumstance has been brought about by the act or failure to act of one of the Members. In the latter case, only the Non-Defaulting Member is given specific remedies.

While the concept is relatively easy to articulate, there are circumstances that might be classified as ''no-fault'' that will flow from the act of one of the Members. For example, the failure of the Members to agree upon a particular course of action may

be a good faith difference of business judgment or it may reflect the deliberate act of one of the Members in order to avoid the consequences of a termination arising as a result of that Member's default. If a Critical Target Failure has occurred because of a lack of funds and could be cured by the infusion of unbudgeted capital, a Member that does not have ready access to capital or that has its capital otherwise committed may determine that it cannot continue with the Company and therefore creates a deadlock resulting in a no-fault termination of the Company. It may be argued that this is a situation in which the Member without capital has deliberately created a situation that is a no-fault termination rather than accepting the need for capital and then defaulting because of its inability to provide its share of the capital needs. Since the funding is unbudgeted, it may also be argued that this represents an extraordinary demand upon the Members that either Member may properly reject.

In the Model JV Agreement, the Members' inability to resolve a Critical Target Failure or a Business Dispute have been assumed to arise because of the Members' good faith inability to find a common basis for overcoming the problem. Consequently, if the Members are unable to resolve a Critical Target Failure or a Business Dispute, either Member may invoke the dissolution provisions.

The facts surrounding the formation of each proposed joint venture should be considered carefully in order to identify the default and no-fault matters that the Parties wish to use as trigger mechanisms.

(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.

Comment

It is important to provide a way of terminating the Company in a situation in which the Company's objectives are not going to be attained. The best way is to provide some objective criteria for measuring success, which if not achieved, give either Member the right to terminate the Company. The most usual criteria would be that some key aspects of the Business Plan are not being met. It is advisable to have a number of interim Critical Targets in addition to major milestones so that a situation does not arise where one Member believes some distant Critical Target will not be met but the other believes it will, perhaps resulting in a situation where the concerned Member is contractually bound to continue to contribute to what it sees as a failing venture. Tying the right to terminate to the Business Plan also permits the joint venturers to refresh the Critical Targets throughout the life of the venture. In order to work well, the Critical Targets should be clearly and specifically defined, particularly if the Members are inclined to use financial projections as their Business Plan. Another, more detailed, approach to Critical Target Failures is set out in the Appendix.

See also the comment to Section 5.8 regarding more complex ''target'' structure.

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

Comment

The Model JV Agreement contemplates that, if a Business Dispute remains unresolved after all of the procedures set forth in Section 5.9 for resolving it have been exhausted, then either Member has the right to terminate the Company as a last resort.

Section 5.9(a) requires that a Member determine that the Management Committee's failure to resolve a Business Dispute will adversely affect the Company and not just the Member, before it can give a Dispute Notice triggering the dispute resolution provisions of Section 5.9(b) that could

ultimately lead to the Member's right to terminate the Company under Article 7. Such requirement is intended to prevent a Member from utilizing the termination provisions of Article 7 to protect the interests of the Member (such as an inability or unwillingness to provide needed funds), as opposed to the Company. The termination rights under Section 7.2(b) apply only in the case of unresolved Business Disputes. Disputes involving Legal Claims are subject to the dispute resolution and arbitration provisions of Article 13.

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).

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

Comment

This section entitles either Member to elect either to dissolve the Company or to invoke the mandatory buy-sell provisions of Article 10 upon the occurrence of one of the events in Section 7.2. The Model JV Agreement provides that these are the exclusive remedies available to the Members upon the occurrence of any of these ''no fault'' events. This reflects a judgment that, in these circumstances, the Members would wish to foreclose the possibility of either Member pursuing a legal claim against the other. This, of course, is subject to negotiation by the Members.

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).

Comment

In addition to the ability of a Member to terminate based on ''no fault'' events, Section 7.4 also gives either Member the right to terminate after the third anniversary of the formation of the Company without specifying a reason. Note that a Member is not entitled to exercise this right if an election has already been made to terminate the Company under Section 7.3 (Remedies—Absence of Default) or Section 8.3 (Remedies—Upon Default by One Member). This is designed to prevent a Member from ''back dooring'' the rights under this Section if the other Member already has elected to terminate for other reasons.

The three year period is selected as, under the hypothetical fact pattern, a reasonable period to determine if the Company will be viable. This may not be an appropriate time period under other facts or circumstances and the drafter should focus on establishing an appropriate period.

The rights granted under this Section, or the three-year time set forth in this Section, may be resisted by Small Member. If the joint venture is performing well after three years and is benefiting Small Member, Small Member would be understandably unwilling to allow Large Member to buy out its interest (assuming that Small Member will be less likely to have the necessary funds available to buy out Large Member's interest). Even though Small Member should receive fair value for its interest upon any such buy-out, it will lose any benefits it derived from the joint venture.

Article 8: Dissolution and Other Rights Upon Default

Comment

This Article, in contrast to Article 7, addresses the remedies of a Member when the other Member is in ‘‘default’’ (Section 8.3) and, further, the remedies if both Members are in default (Section 8.4).

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.

Comment

This Section defines the applicability and directs the reader as to the applicable remedies, depending on whether only one Member is in default or both Members are in default.

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’’:

Comment

Because Section 8.2 contains no overall cure provision, the itemized events need to be reviewed to determine whether additional cure periods should be added. Some of them, such as Sections 8.2(g) (Change of Control) and 8.2(h) (Insolvency), already have cure periods. Similarly, the drafter should consider whether there are any events not listed in the subsections under Section 8.2 that are relevant to a particular joint venture and that should be added.

The following comments in Section 8.2 relate to the ‘‘Default Events’’ that are not self explanatory.

(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.

Comment

Because Additional Capital Contributions and Member Loans are part of the Business Plan that must be approved by both Members, it seems fair that if a Member fails to make an Additional Capital Contribution or Member Loan required by the Business Plan, then the Non-Defaulting Member should have the right to elect (in addition to the remedies provided in Section 3.3) either the dissolution or the buy-sell remedies under this Article 8.

(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.

Comment

The drafter should review and select the relevant representations and warranties, the breach of which should permit a termination, based on the facts of each case.

Representations and Warranties are made not only as part of the formation transactions but also as of each Applicable Closing as defined in Section 14.1(a), which includes the closing of any transfer of cash or property under Section 3.2 by way of Additional Capital Contributions or Member Loans.

(c) *Termination of Existence by a Member*. A Member commences any proceeding to

wind up, dissolve or otherwise terminate its legal existence.

Comment

The above ‘‘Default Event’’ and the three following (Section 8.2(d) (Termination of Existence by Another Person); Section 8.2(e) (Dissociation); and Section 8.2(f) (Prohibited Transfer)) relate to a Member’s fundamental right to be in the Company with a Member of its own choosing. The same is true for Sections 8.2(h), 8.2(i) and 8.2(j), all involving insolvency proceedings that likely result in a new Member (the Bankruptcy Court, if nothing else), as well as Section 8.2(g) (Change of Control), which could result in control of the existing Member moving to an unacceptable party.

(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).

Comment

Most LLC statutes (including DLLCA § 18–603) do not permit a member to withdraw from the limited liability company unless the limited liability company agreement provides otherwise.

(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.

Comment

Careful consideration must be given to the provisions of Section 8.2(g) dealing with a change of control of one of the Members. As discussed in the Commentary to Article 6 (Transfer Restrictions on Member Interests), since the very nature of a joint venture is founded upon the ability of the members to work together, the identity of the Members is basic to the relationship. Therefore, a change in control of one of the Members may lead to new decision makers being introduced to the joint venture and a possible alteration in the relationship between the Members.

Even when the actors are the same, a change of control of one of the Members can have an adverse effect on the joint venture’s enterprise. The new owners of one of the Members may have other or more pressing business priorities and be unwilling or unable to devote the time and resources necessary for the venture to

succeed. A Member's new owners may be in a competitive or potentially competitive field, and the Member that did not suffer a change in control may be reluctant to share certain business information with the other Member's new owners.

For all of these reasons, the consequences of a change of control, and the events that might constitute such a change, should be carefully thought through.

In many cases, whether a change of control has occurred will be determined by some structural change at the highest level of control where policy decisions are made—in the case of a corporation, this usually means an actual or potential change in its board of directors. The criteria for determining changes of that sort in a private and in a public company are discussed below. However, occasionally the success of a joint venture that depends on close collaboration of specific individuals or officeholders of one or both of the Members may depend on those individuals remaining in their present positions. Some joint venture agreements, but not the Model JV Agreement, may, therefore, give one Member certain exit rights if certain named employees or officeholders of the other Member cease to be involved in the joint venture's affairs.

More frequently, however, whether specific individuals are concerned with the success of the joint venture and its business is less important than knowing that the other Member remains institutionally committed to the joint venture as fully as it was when the joint venture agreement was signed. A Member may have a legitimate interest in terminating the Company if certain events occur that change, or may change, the institutional commitment at the governance level where policy of the other Member is made. The Model JV Agreement recognizes that interest, even though such a ''default'' provision could occur through no ''fault'' of, and in fact against the wishes of, the Member suffering the change in control.

In the case of a closely held company where the actions of the owner or controlling group of owners are not likely to be filtered through layers of management, the consequences of a change of control might be readily discernable. Similarly, what constitutes a change of control might be readily apparent. If a person not currently a shareholder of a corporate Member acquires a majority of that Member's shares carrying the right to elect directors, it may be rather clear that a change of control has occurred, and a test of control could be so simply stated. Even in the case of a closely held Member, however, the drafter should consider whether shifting alignments among existing owners, including the creation or dissolution of voting trusts or similar voting arrangements, could have any of the unfortunate results that a change of control provision is designed to avoid.

In the case of a public company (defined by the Model JV Agreement, in general, as a company having securities registered under the Securities Exchange Act of 1934) whose shares are widely held, it may be less apparent when a change of control occurs. A change in ownership of a block of shares that is less than a majority of the outstanding shares of a corporate Member, or that has rights to elect less than a majority of that Member's board of directors, may nevertheless be sufficient to change or materially influence the policies or management of that Member. The Model JV Agreement recognizes that possibility and specifies that an acquisition of more than 30% of a public company's shares having general voting rights in the election of directors will be conclusively deemed to constitute a block sufficient to constitute a change of control. The specific percentage that may be appropriate in each case depends on an analysis of a public company's shareholder profile and the structure of its board of directors.

Section 8.2(g)(ii) deals with a situation that is, in most cases, peculiar to publicly held companies. It addresses tender offers for the outstanding stock of a Member, in which case, the change in control is deemed to occur when the incumbent board or

corresponding governing body approves the tender offer, even though the possibility remains that the offer may not succeed for any number of reasons. Whether the change in control should be deemed to occur then or at the time that board membership actually changes may, like all other tests of when ‘‘control’’ changes, be the subject of negotiations between the Members.

Some corporate Members may be relatively indifferent to the way these change in control tests are formulated. In some cases, they may even regard them as benign anti-take over measures. In other cases, a corporate Member may not want to be deprived of what it perceives as a possible advantage in participating in a future corporate reorganization or, in the alternative, in its investment in the joint venture, and will accordingly seek to limit or minimize the circumstances under which a change of control will be deemed to occur.

Finally, in some instances the change of control provisions may be tied to the new owner being a competitor.

(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, 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.

Comment

Section 8.3 specifies the remedies available to the Non-Defaulting Member that elects to exercise its rights because one of the triggering events listed in Section 8.2 has occurred. The Non-Defaulting Member may dissolve the Company, buy the Member Interest of the Defaulting Member or compel the Defaulting Member to buy its Member Interest. In addition, if the Defaulting Member is Large Member, Section 8.3(c) permits the Small Member to appoint additional Managers so that the Small Member has appointed a majority of the Managers, and thereby controls the Management Committee. See the comment on Section 8.3(c) below.

The rights granted to a Non-Defaulting Member would be inadequate if they were restricted to the right to terminate the Company. The Company may itself be viable. The problem may lie only with the ability of the Defaulting Member to meet its obligations. In that case if the only right of the Non-Defaulting

Member was to terminate the Company, that Member might be prejudiced by the acts of the Defaulting Member. To provide an equitable solution, the Model JV Agreement provides for the right of the Non-Defaulting Member to purchase the Member Interest of the Defaulting Member on the terms and conditions set out in the Model JV Agreement.

The notice electing a remedy under Section 8.3 must be given within the stated time following the discovery of the event giving rise to the right. A Member entitled to exercise a remedy should not be permitted to allow the event that gave rise to the right to continue indefinitely and to raise it only when convenient. The choice of the appropriate time may be altered to suit the circumstances but some realistic time frame should be used to limit the actions of the Non-Defaulting Member. If no action is taken within the stated time, the underlying assumption of the Model JV Agreement is that the default was not a sufficiently important event to warrant action by the Non-Defaulting 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.

Comment

Section 8.3(a)(ii) allows the Non-Defaulting Member to buy the Defaulting Member's Member Interest at 90% of its Fair Market Value. ''Fair Market Value'' is defined in Section 11.2, and the discounted purchase price is addressed in greater detail in Section 11.3. The reason for discounting a purchase price by a stated percentage is to compensate the Non-Defaulting Member for its resulting costs, such as the unanticipated burden of raising the capital needed to buy out its co-venturer.

At the same time, allowing the Non-Defaulting Member to buy the Defaulting Member's Member Interest at a stated discount from Fair Market Value might have certain disadvantages. Among these is whether a court might regard a provision permitting the Defaulting Member's interest to be purchased at a stated discount as a penalty, and therefore unenforceable. Section 11.3 is intended to address that concern. Whether or not such a discounted purchase price would be so regarded, or whether Section 11.3 is sufficient to prevent it from being so regarded will be determined by state law, and should be carefully considered by the drafter. See Comments to Section 11.3. However, provisions in the DLLCA may help to overcome an argument that the discounted purchase price is an unenforceable penalty. *See* DLLCA §§ 18–306 and 18– 502(c) (permits ''forfeiture'' of a member's interest upon the member's failure to perform in accordance with the LLC agreement, as well as the ''fixing of the value of . . . [the member's] . . . interest by appraisal or by formula and redemption or sale of [such] interest at such value . . .''). The drafter must judge whether a specific discount is so great that it is likely to be considered a penalty, or so small that it might fail to completely redress the Non-Defaulting Member's loss, and whether the difficulty in making that judgment itself raises a question

of enforceability in jurisdictions in which liquidated damages must represent a reasonable estimate of probable loss.

The drafter should also consider whether a discounted purchase price is reasonable in the case of buyout resulting from a change in control that the Defaulting Member may have suffered involuntarily. Another consideration is whether such a discount might increase the likelihood that a bankruptcy trustee or debtor in possession would challenge the buyout if the Defaulting Member is bankrupt or insolvent.

In addition to a stated discount from Fair Market Value the drafter might include a definition of Fair Market Value that specifically provides that it must reflect any diminution in value caused by the event giving rise to the buyout. That provision would seek to build into the purchase price any damages that the Non-Defaulting Member suffered that could be measured by the diminution in the value of the Company. As an alternative, or in addition to such a provision, the joint venture agreement might specifically provide that all other remedies, under the indemnification provisions of Article 14 or otherwise, remain available to the Non-Defaulting Member. See the Comment to Section 8.3(b) below.

(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.

Comment

This may not be a realistic alternative, but it is one the drafter should consider.

(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) . 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.

Comment

This Section deals with exceptions to the exclusiveness of the remedy elected by the Non-Defaulting Member under Section 8.3(a) (as expressly provided in the parenthetical at the end of the introductory language of Section 8.3(a)). The Non-Defaulting Member's election to dissolve the Company under Section 8.3(a)(i) will not deprive that Member of any other remedy it may have under the indemnification provisions of Article 14 or at law. By contrast, the Non-Defaulting Member's election to buy the Defaulting Member's Member Interest under Section 8.3(a)(ii) or to sell its Member Interest to the Defaulting Member under Section 8.3(a)(iii) is an exclusive election that precludes the exercise of other remedies. The election of remedies reflects the fact that the Non-Defaulting Member is entitled to buy the Member Interest of the Defaulting

Member at 90% of its Fair Market Value under Section 8.3(a)(ii) or to compel the Defaulting Member to buy its Member Interest at full Fair Market Value, and that it should look to those Sections for redress of any costs it may have incurred. As discussed in the comments to Section 8.3(a), those provisions may not adequately compensate the Non-Defaulting Member for any diminution in value caused by the event giving rise to the buyout. If some alternative to the purchase at stated discount is adopted in Section 8.3(a)(ii), the drafter should carefully reconsider the applicability of Section 8.3(b) and the broader scope of remedies that might then be appropriate.

Section 8.3(b)(ii) provides a cross-reference to Small Member's rights under Section 8.3(c) and also preserves injunctive relief. Although the Non-Defaulting Member's right to buy the Defaulting Member's Member Interest under Section 8.3(a)(ii), or its right to sell its Member Interest to the Defaulting Member under Section 8.3(a)(iii), are exclusive remedies, clause (C) of Section 8.3(b)(ii) preserves the right of the Non-Defaulting Member to bring a derivative action in the name of the Company to recover amounts owed to the Company that are not otherwise reflected in the determination of Fair Market Value. Clause (C) is included as an exception to the exclusive remedies because limited liability company agreement provisions restricting or limiting the right of a member to bring a derivative action are of questionable enforceability. *See* Comment to Section 2.11(b).

Section 8.3(b)(iii) provides that the Non-Defaulting Member's legal fees will be borne by the Defaulting Member.

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

Comment

When one Member is a ''Defaulting Member,'' Section 8.3(c) makes possible

one of two kinds of changes in the management structure of the Company that appears in Article 5. The kind of change that can be made depends on the remedy the Non-Defaulting Member has selected under Section 8.3(a) and, in the first case described below, is available only to the Small Member. The subsections of Section 8.3(c) discussed below make it clear that those changes in management are not remedies that can be exercised apart from the other remedies set forth in Section 8.3(a), but that the change is effective only while one of those other remedies is being actively pursued. In other words, controlling the management of the Company is only incidental to accomplishing dissolution or a purchase and sale.

While reviewing the comments on the subsections of Section 8.3(c) discussed below, the drafter should keep in mind that, in each case, Section 5.10 (Standard of Conduct) remains applicable to the Member that effectively controls the decisions of the management of the Company.

Of course, a drafter who alters the voting arrangements or the management structure set forth in Article 5 of the Model JV Agreement should also consider whether Section 8.3(c) is still needed or whether some variation of it is appropriate. The essential point for the drafter is that a joint venture agreement is particularly an organic instrument, all of whose parts must work together; the mechanics of how one part, such as the ‘‘remedy’’ section, will work in practice must be considered in the light of each other part, such as the governance provisions of Article 5.

(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 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

Comment

If the Non-Defaulting Member is Small Member, and it elects to buy the Defaulting Member's Member Interest under Section 8.3(a)(ii), Section 8.3(c)(i) allows it to appoint additional Managers and the chairman of the Management Committee so that the Managers it has appointed can cast the tie-breaking votes for most actions of the Management Committee.

Section 8.3(c)(i) is necessary because, even though each Member appoints two managers under Section 5.1(b), under Section 5.3(b) the chair of the Management Committee, who is always appointed by Large Member, casts the tie-breaking vote when the Management Committee is deadlocked. In the absence of Section 8.3(c)(i), Large Member could continue to exercise that control, even when it is the Defaulting Member. Merely disabling the chairman's tie-breaking vote would mean that neither Member could control the actions of the Management Committee. While that is an alternative the drafter could consider in this situation, it could also result in a paralysis of the Company's business in circumstances when one Member will certainly try to preserve and to continue it.

Instead, Section 8.3(c)(i) allows Small Member, if it is the Non-Defaulting Member, to assume control of the management of the Company, except for matters that require the assent of representatives of both Members under Section 5.4, which continues to apply for the protection of the Defaulting Member. After invoking Section 8.3(c)(i), Small Member's Managers can effectively take any

other action by written consent under Section 5.2(d), but the Defaulting Member is still entitled under that Section to notice of actions taken. Thus, Section 8.3(c)(i) preserves some protections for the Defaulting Member while enabling the Non-Defaulting Member to effectively carry on the business while the buyout is underway.

(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).

Comment

In contrast to the middle course taken by the preceding Section discussed above, Section 8.3(c)(ii) requires the Non-Defaulting Member that elects to dissolve the Company under Section 8.3(a)(i) to assume full control of the management of the Company, even to the extent of being able unilaterally to take those actions that, under Section 5.4, previously required the assent of representatives of both Members. It is true that many of the actions listed in Section 5.4, such as the admission of new members, may not be necessary for, or may be inconsistent with, dissolution of the Company. At the same time, other such actions, such as the sale or disposition of all of the Company's assets are required, and Section 8.3(c)(ii) takes the more general course of permitting the Non-Defaulting Member the broadest latitude in carrying out dissolution under Article 9. As noted above, the provisions of Section 5.10 (Duties of Care and Loyalty) remain applicable to the Member that effectively controls the

Company, even pending dissolution.

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).

Comment

This Section, while redundantly stating that elections create obligations and providing a cross-reference to implementing Articles, seems useful.

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.

Comment

This Section is intended to place both members on equal footing if they are both in, or become in, default before a sale of a Member Interest pursuant to Section 8.3(a)(ii) (Right to Buy) or 8.3(a)(iii) (Right to Sell), by directing that the

remedy is under 8.3(a)(i) (Dis-solution).

Section 8.4 applies in a situation where a Non-Defaulting (at the time) Member has given notice and the parties are well into the process of buying out the original Defaulting Party's interest, when the Non-Defaulting Member defaults. Much time, effort and expense will have been incurred and the parties are near closing the sale when suddenly everything is off and the entity *must* now be dissolved. Additionally, a deposit may have been made under Section 8.3(a)(ii) which the original Non-Defaulting Member may have difficulty getting back. The drafter may wish to provide an alternative remedy in such situation so that all of the effort and expense will not be lost.

Article 9: Dissolution Procedures

General Comment

As pointed out above, Section 8.3(c)(ii) specifically vests all of the decision making authority relating to the management of the Company in the hands of the Non-Defaulting Member during the course of liquidation resulting from default by the other Member.

The drafter should consider whether to include provisions that would impose additional obligations on the Non-Defaulting Member during the course of the winding up of the Company. For example, should there be an obligation imposed on the Non-Defaulting Member to minimize the costs of the winding up?

The drafter should model the procedures in Article 9 to fit the dissolution provisions of the appropriate state LLC statute.

9.1 Generally. Promptly after a Member delivers a notice electing to dissolve the Company or upon any other event requiring dissolution or winding up of the Company:

(a) if there is notice delivered pursuant to Section 7.3(a) (Dissolution—Absence of Default), the Managers will proceed to wind up the affairs of the Company in the manner set forth in this Article; or

(b) if there is notice delivered pursuant to Section 8.3(a)(i) (Dissolution—Upon Default), the Non-Defaulting Member will wind up the Company's affairs in the manner set forth in this Article on behalf of the Members; or

(c) in the case of any other event requiring dissolution, liquidation or winding up of the Company, the Managers will proceed to wind up the affairs of the Company in the manner set forth in this Article.

After such notice or other event, neither Member will be obligated to provide any additional funds that would otherwise be required by the Company except amounts owing by such Member pursuant to this Agreement or other contractual arrangement. It is the intent that the events in Section 7.2 (Triggering Events—Absence of Default) and Section 8.2 (Definitions— Defaulting Member and Non-Defaulting Member and Default Event) are the only dissolution events, and thus those provisions of the DLLCA that specify other dissolution events are hereby overridden by the foregoing contrary provisions of this Agreement.

Comment

Section 9.1, and specifically 9.1(c), recognizes that some state statutes may have provisions that require the dissolution or winding up of the Company in addition to provisions that may be contained in the Agreement.

Because of the nature of a limited liability company, a Member would be liable only for amounts contractually owed by it to the Company or other parties but not for other liabilities or obligations of the Company. Such other liabilities or obligations could be specifically assumed by a Member in the Model JV Agreement or through other agreements entered into by the Member such as contracts in support of financings. In that event, those documents would determine the liability of the Member.

9.2 Method of Sale. If the Facility has been completed and the Company has recorded revenue from sales of New Products, then the Managers (in the case of a

dissolution under Section 7.3(a) (Dissolution—Absence of Default)) or the Non-Defaulting Member (in the case of a dissolution under Section 8.3(a)(i) (Dissolution—Upon Default)), as applicable, will retain a business broker and will cause the business of the Company to be listed for sale as a going concern. If either (a) an offer reasonably acceptable to Managers or the Non-Defaulting Member, as applicable, has not been received within 120 days of listing the Business for sale or (b) if the Facility has not been completed or the Company has not recorded revenue from sales of New Products, then the assets of the Company will be sold in the manner determined by the Managers or the Non-Defaulting Member, as applicable, whether in whole or in part. The Managers (in the case of a dissolution under Section 7.3(a) (Dissolution—Absence of Default)) or the Non-Defaulting Member (in the case of a dissolution under Section 8.3(a)(i) (Dissolution—Upon Default)) will liquidate the Company's assets and discharge the liabilities of the Company over a reasonable time in order to minimize the losses that may otherwise result from an immediate liquidation.

Comment

There are several different options that can be considered for the sale of the business. The use of a business broker or investment banking firm to solicit offers is one. Underlying the Model JV Agreement requirement to use a business broker is the fact that there is an operational business to sell. This provision of the Model JV Agreement provides for reliance on the professional expertise of a business broker to find a buyer for the business. In lieu of this, the Non-Defaulting Member could directly solicit offers itself, which is time consuming and may well be beyond its expertise. Another option is to hold a public auction of the business. One of the more attractive features of a public auction is the ability of either of the Members, or if one of the Members is in default, perhaps only the Non-Defaulting Member, to be one of the bidders at the auction.

In considering the insertion of an auction provision in the Model JV Agreement, one

must consider the alternative right that a Non-Defaulting Member has to purchase the Member Interest of the Defaulting Member under the Model JV Agreement. The auction becomes more interesting if there is a desire to sell out and maximize the price that can be obtained for the business. A member can protect against a low bidder either by a reserve bid or by attending the auction and entering the bidding at any time.

If the Company either owns or is the exclusive licensee of intellectual property rights that the Non-Defaulting Member would not wish to fall into the hands of certain competitors, then instead of a public auction, it may be preferable to have a private sale in which the buyer to whom the business will be sold will be more suitable, even if the purchase price is less than might otherwise be obtained. Selling the business at less than the best available price in order to avoid a damaging sale to a competitor may put the Non-Defaulting Member at the risk of attack by the Defaulting Member for not acting in the best interests of the Company. It is preferable to ensure that the licensing agreements contain protection by way of limiting the rights of transfer of the intellectual property in the event the business is to be sold.

As set forth in the Fact Pattern, the Company will own the jointly developed intellectual property and each Member is licensing a portion of its technology to the Company. In any context where the Members are not both in agreement to sell the Company or the Member's interest in the Company, the Members need to consider whether that Member's licensing obligations will continue after the sale and, if so, whether that Member needs or desires to have certain rights in the intellectual property of the Company after the sale.

9.3 Application of Proceeds of Liquidation. The proceeds of the liquidation of the Company will be applied in the following order:

(a) to the payment of the expenses of liquidation;

(b) to the payment of the liabilities and obligations of the

Company, other than those owing to a Member; and

(c) thereafter in accordance with Sections 4.3(c) (Pay Member Loans) and 4.7 (Liquidating Distribution Provisions).

Distributions in accordance with Section 4.7 required by this Section 9.3(c) may be made in non-cash property either (i) on a pro rata basis to each Member or (ii) as the Members may otherwise agree.

Comment

If property contributed to the Company is distributed in dissolution to a Member that was not the contributing Member, taxable income could be realized by the contributing Member depending on the nature of the property and the time held by the Company. IRC § 707. **This assumes the Company is taxed as a partnership.**

9.4 Certified Liquidation Statement. Either (i) the Managers, if the Company is dissolved pursuant to Section 7.3(a) (Dissolution—Absence of Default) or (ii) the Non-Defaulting Member, if the Company is dissolved pursuant to Section 8.3(a)(i) (Dissolution—Upon Default) will cause the Company's independent auditors to prepare a certified liquidation statement of the Company. Each Member agrees to prepare its financial statements and to prepare and file all tax returns required to be filed by it in accordance with that liquidation statement, which will contain:

(a) a summarized statement of receipts and disbursements (including expenses of dissolution);

(b) a determination of the Book Capital Account of each Member;

(c) a statement of the liabilities of the Company owing to each Member;

(d) an allocation between the Members of all gains or losses realized on the liquidation of the assets of the Company; and

(e) an allocation of any tax attributes between the Members.

Article 10: Buy-Sell in the Absence of Default

General Comment

As provided in Article 7 (Dissolution or Buy-Sell—In the Absence of Default), Article 10 is available only if neither Member is in default and if one of the events specified in either Section 7.2 (Triggering Events—Absence of Default) or Section 7.4 (Voluntary Buy-Sell) has occurred, namely (a) if there has been a deadlock by the Members in their efforts to resolve a Business Dispute (Section 7.2(b)); (b) if there has been a failure by the Members to agree upon and implement a plan to remedy a Critical Target Failure (Section 7.2(a)); or (c) under Section 7.4 after the expiration of the initial ‘‘lock-in’’ period during which the Members have agreed that a voluntary dissociation should not be available. Section 7.4 sets that period at three years which, under the Fact Pattern, is a reasonable period of time to get the Company to a point where it is viable. It may not be in the specific facts and circumstances of another case.

10.1 Offer to Buy or Sell. At any time after any of the events specified in Section 7.2 (Triggering Events—Absence of Default) or Section 7.4 (Voluntary Buy-Sell), either Member (the ‘‘Offeror’’) may give written notice (the ‘‘Offer’’) to the other Member (the ‘‘Offeree’’), stating that the Offeror offers unconditionally at the option of the Offeree both:

(a) to purchase the entire Member Interest of the Offeree and

(b) to sell the entire Member Interest of the Offeror to the Offeree,

in each case with the same purchase price specified for each percentage point of Member Interest of the selling Member.

Comment

The mechanics of Section 10.1 are well known and straightforward. One Member gives a notice stating a price at which it is willing to sell its interest or

buy the other Member's interest. The Member receiving the notice then has the option either to buy the offering Member's Member Interest at the stated price or to require the offering Member to buy the Member's interest at the same price. The theory is that, if one cuts the cake and the other chooses which piece to take, the division of the cake (or the price, in the case of the buy-out) is likely to be fair.

Of course, a Member that has less financial wherewithal than the other Member, or has a much smaller percentage interest than the other Member, may be understandably reluctant to initiate the process when it is uncertain whether it will end up being the buyer or seller. Presumably, in a ''non-default'' situation, a Member wishing to exit the Company will first have entered into negotiations with its counterpart to strike an agreement for the sale of its interest, possibly on terms other than those in the joint venture agreement. In practice, the best terms of dissociation are usually those determined by negotiations between the joint venturers at the time of dissociation based on all of the facts they know at that time. Some see the uncertainty of the outcome of this exit technique as its virtue: it encourages the joint venturers to arrive at a freely negotiated, fair and reasonable outcome while providing a backstop if those efforts fail. See Comment—''Other Valuation Approaches'' at the end of this Article 10 for alternatives.

In the context of this provision, each Member needs to consider whether such Member's licensing obligations will survive the sale and if so to what extent such Member needs or desires to retain certain rights in the intellectual property of the Company after such sale.

10.2 Terms of the Offer. The Offer must be accompanied by an irrevocable standby letter of credit available through the Non-Default Buy-Sell Closing Date (as defined in Section 10.4) in an amount sufficient to purchase the entire Member Interest of the Offeree.

The Offer will be irrevocable by the Offeror until the earlier of (a) the Non-Default Buy-Sell Closing Date or (b) the date on which the Offeree elects to purchase the Offeror's Member Interest pursuant to Section 10.3(a)(ii). The Offer will not have any other terms; *provided, however*, that the purchasing Member will undertake to (i) assume at the Non-Default Buy-Sell Closing Date all known obligations of the selling Member to third parties in connection with the selling Member's Member Interest (with a corresponding reduction in the purchase price) and (ii) use Best Efforts to obtain the release of the selling Member from known obligations between the date of the Offer and the Non-Default Buy-Sell Closing Date

Comment

The financial ability of a Member to complete the process once it is begun may also be of concern to the other Member. There are several ways to deal with that concern. The first sentence of Section 10.2 requires the Member invoking the procedure to provide a letter of credit in the amount of the proposed price. While that may comfort the other Member, it can also be expensive. An alternative may be to provide that:

> ''The Offer will be accompanied by one or more binding written commitments from substantial and reputable financial institutions to provide the purchasing Member with funds sufficient to purchase all of the Member Interest, subject only to conditions that are customary in such commitments and that are reasonably likely to be satisfied.''

Joint venture agreements frequently impose no ''credit assurances'' in connection with an offer.

At the same time it may be sufficient to provide, as does Section 10.6, that a Member that defaults in its obligation to complete the purchase must then sell its interest to its non-defaulting Member at a discount. Any such amount should be set only after lawyers have considered its enforceability under applicable law. See the comments as

to discounts to Fair Market Value in the Comment on Section 8.3(a)(ii).

The drafter needs to consider how to address unknown liabilities, particularly whether there should be a separate indemnity for the selling Member's share of the unknown liabilities or if that is simply reflected in the pricing.

10.3 Offeree's Response to Offer.

(a) *Offeree's Response*. At any time during the 30 days following receipt of the Offer, the Offeree may give the Offeror a written notice electing either to:

(i). sell the entire Member Interest of the Offeree to the Offeror, or

(ii). buy the entire Member Interest of the Offeror (in which case the Offeree's notice must be accompanied by an irrevocable standby letter of credit available through the Non-Default Buy-Sell Closing Date, as such date may be extended pursuant to this Agreement, in an amount sufficient to purchase the entire Member Interest of the Offeror),

in either case upon the terms in this Article 10 and otherwise as set out in the Offer.

(b) *Effect of Offeree's Failure to Respond*. If the Offeree fails to give the notice within the 30 day period or if the Offeree's notice is not accompanied by the required letter of credit, then it will be conclusively deemed to have accepted the Offer of the Offeror to purchase the Offeree's Member Interest pursuant to Section 10.1(a) in accordance with the terms of the Offer.

Comment

If the Offeree elects to purchase the Member Interest of the Offeror, the Offeree's notice also must be accompanied by a standby letter of credit in the amount of the purchase price. See the Comment to Section 10.2 as to alternatives to providing a letter of credit.

10.4 Closing and Date of the Closing. The closing (the ''Non-Default Buy-Sell Closing'') of the purchase and sale will take place on the 60th day following the date on which the Offer under Section 10.1 (Offer to Buy or Sell) is received, or, if that day is not a

Business Day, on the next following Business Day (the ‘‘Non-Default Buy-Sell Closing Date’’). The Non-Default Buy-Sell Closing Date will be extended to the extent necessary for either Member to secure any required governmental approval or consent to a date five Business Days following such approval or consent so long as that Member is using its Best Efforts to pursue the approval or consent and every 30 days during the extension delivers to the other Member a certificate that approval is being so pursued. For purposes of this provision, ‘‘governmental approval or consent’’ includes expiration of the Hart-Scott-Rodino waiting period and similar merger control provisions that do not constitute formal approvals or consents. The Non-Default Buy-Sell Closing will take place at 11:00 AM on the Non-Default Buy-Sell Closing Date at the offices of the lawyers for the Company (or, if there are none, at the offices of the lawyers for the purchasing Member).

Comment

This Section permits an extension of the Non-Default Buy-Sell Closing Date beyond the 60 days to obtain any required governmental approvals of the sale.

10.5 Deliveries at the Closing. At the Non-Default Buy-Sell Closing, the purchasing Member will pay the purchase price for the selling Member’s Member Interest in immediately available funds, and the purchasing Member will deliver to the selling Member the items described in Section 11.7 (Default Buy-Sell Closing—Purchasing Member Deliveries). The selling Member will deliver the items described in Section 11.6 (Default Buy-Sell Closing—Selling Member Deliveries).

Comment

This Section undertakes to achieve brevity by cross-referencing the closing deliveries required by Section 11.6 (Default Buy-Sell Closing—Selling Member Deliveries) and Section 11.7 (Default Buy-Sell Closing—Purchasing Member Deliveries).

10.6 Default by Purchasing Member. If the purchasing Member defaults in any of its material closing obligations, then the selling Member will have the option to purchase the purchasing Member’s entire Member Interest at a price for each percentage point of

Member Interest of the purchasing Member that is 75% of the purchase price for each percentage point of Member Interest that would have been payable on the original closing. The option is to be exercised by notice to the purchasing Member not later than 60 days after the original Non-Default Buy-Sell Closing Date. The Closing will occur at a date and time reasonably designated in the notice, which date will not be later than 90 days after the notice and otherwise in accordance with Article 11 (Buy-Sell Upon Default). If the selling Member exercises its option provided in this Section 10.6, then the selling Member will suffer damages as a consequence of such default; therefore, if a purchase is subject to this Section, the difference between the Purchase Price and the Fair Market Value will be regarded for all purposes as liquidated damages and not as a penalty.

Comment

As noted above, this Section requires a Member that defaults in its obligation to complete a purchase to sell its Member Interest to the Non-Defaulting Member at a discount. The drafter should carefully review the enforceability of this discount under applicable law. See Comments to Section 8.3(a)(ii).

The first sentence of Section 10.6 limits defaults by the purchasing Member to defaults of a ‘‘material’’ closing obligation to avoid an inequitable result because of a minor infraction.

Section 10.6 also does not require the original ‘‘selling Member’’ to put up a letter of credit should that Member become the ‘‘purchasing Member’’ under Section 10.6 because the original ‘‘purchasing Member’’ is in default. The original ‘‘purchasing Member’’ must, therefore, run the risk that the new ‘‘purchasing Member’’ will not be able to financially accomplish the purchase of the Member Interest. This may not be appropriate in certain circumstances.

In addition, the Model JV Agreement does not address the situation of the original ‘‘selling Member’’ failing to close its purchase within the time period specified in Section 10.6. For clarification purposes, the drafter may want to provide that ‘‘all bets

are off'' and the Members must go back to the situation as it was prior to the first notice that set the buy-sell procedures in motion.

Comment—Other Valuation Approaches

Other valuation approaches are available. All, however, attempt to deal with two principal concerns: achieving a fair price and providing a procedure which offers a level playing field.

Alternatives to the ''I cut the cake—you select the slice'' approach of Section 10.1 are discussed below.

The first is providing a set formula by reference to one or more financial measures such as book value, a multiple of earnings or some variation on discounted cash flow or some combination of the three. Which measure is most appropriate depends to a large degree on the business the venture is engaged in. While a formula approach has the advantage that each joint venturer can know with some certainty what the price will be before initiating the exit procedure, it also has significant drawbacks. Circumstances prevailing when the process is invoked which were not anticipated when the formula was chosen can result in a price that is not fair to one joint venturer. Because financial measurements can depend on the interpretation and application of a number of accounting principles, some of which admit of different variations and approaches, they should be carefully defined. Finally, and perhaps most significantly, when either Member can invoke the exit procedure at will and the Members perceive some strategic advantage in moving first (such as being the one to name the price), removing all uncertainty from that procedure can promote a rush for the door when times get bad.

A second method of setting the price is by appraisal. This is the method used in Section 11.4, in large measure because in such a ''default'' situation it is likely that one Member may be unable or unwilling to cooperate in the sale process in

the way in which the auction process requires. Considerations which should be brought into play when drafting appraisal provisions are covered in the commentary to that Section.

A third method of setting price is some variation on the auction theme, of which the Model JV Agreement text gives a very basic example. It is predicated on the belief that the parties are themselves in the best position to determine the value of the enterprise and therefore to determine the price that one joint venturer should pay the other, and that price is best determined at the time the exit is invoked. The Model JV Agreement text gives the prerogative of naming the price to the first Member to invoke the process.

These approaches can be combined in creative ways. Two illustrations—Variation One and Variation Two—follow.

Variation One

One variation that gives both Members a say in fixing the price also illustrates that more than one method of determining price can be incorporated in the same provision. In this variation, each Member submits its buy and sell price to a third party and the price is the average of the two submissions—unless the higher price is more than 110% of the lower price. In that event the Members turn the process over to an appraiser. In the variation given below, the appraiser independently determines the value of the Member Interest based on the valuation method or methods that the appraiser determines to be most appropriate in light of the standards set forth in the agreement. The text below gives a general standard: a value that would be derived in a sale of all interests to the highest bidder in an open auction in which the Members are free to participate. The text also allows each Member to submit to the appraiser the valuation method preferred by that Member and the factors that the Member believes should be taken into account in the course of the valuation. The appraiser may, but is not required to, take those submissions into account in the course of its

work. Depending on the circumstances of each case, the parties may wish to define with greater specificity the standards that the appraiser must follow.

In some variations on this approach the appraiser's value is then compared to the valuations submitted by the Members. The purchase price is then the average of the two values that are nearest to each other. The following text takes a slightly different approach: the purchase price is the valuation submitted by one of the Members that is nearest to the appraiser's value. Because neither Member wants to have its valuation ignored when the purchase price is determined, the procedure in the text below gives the Members an added incentive to specify an objectively realistic valuation when they first submit their bids.

In this variation, the text of Article 10 remains as it appears in the Model JV Agreement except that the purchase price is not specified in the offer, and the terms of the offer in Section 10.2 and the response in Section 10.3 require the notifying joint venturer to specify ''. . . the name and address of an independent appraisal firm or its affiliate neither of which has acted for or been retained by either Member or by any corporation controlling, controlled by or under common control with either Member and which has agreed to determine the value of the Member Interest in accordance with this Model JV Agreement (the ''Independent Appraisal Firm'').'' A new Section 10.X then describes the bid submission process as follows:

10.X *Determination of Purchase Price of Each 1% Member Interest*.

10.X(a) *Determination of Price by Sealed Bid.* Within [30] days after receipt of the Offer by the Offeree, each of the Offeror and the Offeree will submit to the Independent Accounting Firm a sealed bid (a ''Valuation'') that will contain the submitting joint venturer's determination of the value of each 1% Member Interest of the selling Member. Failure by one joint venturer to timely submit a Valuation will be deemed to be an acceptance by such joint venturer of the Valuation submitted by the other joint venturer. If the higher

Valuation is less than 110% of the lower Valuation, the purchase price for each 1% Member Interest will be the average of the two Valuations.

10.X(b) *Valuation*. If the higher Valuation is more than 110% of the lower Valuation, the Independent Accounting Firm will determine the value of each 1% Member Interest of the selling Member (the ‘‘Appraised Value’’) within [60] days after the date of receipt of the Offer by the Offeree. The Independent Accounting Firm will use one or more valuation methods that the Independent Accounting Firm in its best professional judgment determines to be most appropriate assuming that the selling Member’s Member Interest is being sold as part of a sale of all of the equity interests in the Company to the highest bidder after conducting an open auction for the Company (in which auction the Members were free to participate). At any time before the expiration of [60] days after the date of receipt of the Offer by the Offeree, each Member may submit to the Independent Accounting Firm (with a copy required to be simultaneously delivered to the other Member), a proposed methodology of valuation or a list of any factors that such Member believes should be taken into account in such valuation. The Independent Accounting Firm may, but will not be required to, take such submission into account in determining its valuation. The purchase price for each 1% Member Interest will be the Valuation nearest to the Appraised Value.

10.X(c) *Notification of Appraised Value.* The Independent Accounting Firm will notify the parties in writing of the Appraised Value within [60] days of the date of receipt of the Offer by the Offeree and will submit to each Member a statement as to the methodology by which the Appraised Value was determined.

Variation Two

An initial bid or starting price does not necessarily have to originate with the parties. In the early 1990's two large chemical companies entered into a partnership agreement with an exit provision that reversed the order of the variation given above: when the exit mechanism was invoked, the parties retained an appraisal firm they had identified in advance to give an estimate of the ''going concern'' value of the venture. That amount became the initial bid at which the partner that started the process could offer to buy the other partner's interest. If the partner that started the process failed to submit that bid, the other partner had the right to buy the interest of the partner that started the process at the appraised value.

The variation used by the chemical companies also departed from the Model JV Agreement in two other respects. First, rather than a simple two-step procedure where one Member names a price and the other decides whether to buy or sell, it allows the parties to submit counter offers in increasing amounts to assure that the highest value is received. The number of rounds in the negotiation is, of course, subject to negotiation by the parties. Second, it gives the Members the option to decline to initiate the bidding process after the going concern value is received from the appraisal firm and instead to put the entire company up for auction at which all parties can be bidders.

The text of this variation is given below as an alternative to Sections 10.1–10.4 of the Model JV Agreement. Further variations based on this text are possible. For example, a multi-round bidding process by the parties (which either follows an appraisal or is initiated without one) could give each Member an option to accept or decline an offer by the other but compel neither Member to buy or sell at any point in the process. If neither Member has exercised an option to buy or sell when the bidding process has concluded (either at the end of the maximum number of rounds permitted by the Model JV Agreement or when either Member stops submitting counter offers) a public auction procedure described in the following text is then begun. The latter has

the advantage of not compelling either Member into being a buyer or seller while avoiding locking either Member into the venture.

Article 10: Buy-Sell in the Absence of Default.

10.1 Election to Initiate Sale Procedure. At any time after the occurrence of any of the events specified in Section 7.2 (Triggering Events—Absence of Default) or Section 7.4 (Voluntary Buy-Sell), either Member (the ''Offeror'') will be entitled to give written notice to the other Member (the ''Offeree''), stating that the Offeror elects to commence the procedures contained in this Section 10.1. Once given, that notice cannot be withdrawn nor may the procedures be terminated except with the written consent of both Members.

(a) *Valuation.* Within 30 days after receipt of the notice specified in Section 10.1, the Parties will engage _____ (the ''Firm'') to render an opinion as to the going concern value of the Company. Neither Member may seek to disqualify the Firm for reason of conflict of interest. If the Firm cannot be engaged and the Members cannot agree on an alternative Firm within such 30 day period, each Member will then appoint one investment banking firm (collectively, the ''Alternative Firms'') within five days of the expiration of such 30 day period and the Alternative Firms will then jointly select another investment banking firm that will render the opinion as to its estimate of the going concern value within 30 days of their appointment. In any such case, the Firm or such other investment banking firm, as the case may be, will render its opinion in writing to the Members within 60 days of its appointment and the cost of such opinion will be borne entirely by the Company. The valuation thus derived, when multiplied by a Member's Member Interest in the Company, will be the ''Determined Value'' of that Member's Member interest in the Company.

(b) *Commencement of Bidding.*

(i). Upon receipt by the Company of the valuation pursuant to Section 10.1(a), the Offeror will have 45 days to notify the Offeree in writing of the

Offeror's decision to exercise its right, subject to Sections 10.1(b)(ii) and 10.1(b)(iii) below, to purchase all of the Offeree's Member Interest at a price equal to the Determined Value of the Offeree's Member Interest (the ''Offeror's Initial Bid''). If the Offeror decides not to exercise the right contained in this Section 10.1(b)(i) or fails to notify the Offeree within 45 days of receipt by the Company of the valuation pursuant to Section

(ii). 10.1(a) of the Offeror's decision to exercise its purchase right, then the Offeree will have 14 days from the expiration of the 45 day period to notify the Offeror in writing of the Offeree's decision to exercise its right to purchase all of the Offeror's Member Interest at a price equal to the Determined Value of the Offeror's Member Interest (the ''Offeree's Initial Bid'').

(iii). If the Offeror makes the Offeror Initial Bid pursuant to Section 10.1(b)(i), the Offeree will have 14 days from the date it received the Offeror's Initial Bid to notify the Offeror in writing of its decision to exercise its right, subject to the next sentence and Section 10.1(b)(iii), to purchase all of the Offeror's Member Interest at a price equal to at least 105% of the Determined Value of the Offeror's interest (the ''Offeree's Initial Counter Bid''). If the Offeree makes the Offeree Initial Counter Bid pursuant to this Section 10.1(b)(ii), then the Offeror will have 5 days from the date it received the Offeree's Initial Counter Bid to notify the Offeree in writing of the Offeror's decision to exercise its right, subject to Section 10.1(b)(iii), to purchase all of the Offeree's Member Interest at a price equal to the same percentage (rounded upwards, if necessary, to the nearest 1/10th of 1% [0.001]) above the value of the Offeree's Member Interest as the Offeree's Initial Counter Bid was above the price offered for the Offeror's Member Interest (the ''Offeror's Initial Counter Bid''). If the Offeror makes the Offeror's Initial Counter Bid pursuant to Section 10.1(b)(ii), then the Offeree will have five days from the date it received the Offeror's Initial Counter

Bid to notify the Offeror in writing of its decision to exercise its right, subject to the next sentence, to purchase all of the Offeror's Member Interest at a price equal to at least 105% of the price contained in the Offeree's Initial Counter Bid (the ''Offeree's Final Bid''). If the Offeree makes the Offeree's Final Bid pursuant to this Section, then the Offeror will have five days from the date it received the Offeree's Final Bid to notify the Offeree in writing of the Offeror's decision to exercise its right to purchase all of the Offeree's Member Interest at a price equal to the same percentage (rounded upwards, if necessary, to the nearest 1/10th of 1% [0.001]) above the price offered for the Offeree's Member Interest as the Offeree's Final Bid was above the price offered for the Offeror's Member Interest (the ''Offeror's Final Bid'').

(iv). If, at any time during the conduct of the procedures contained in Sections 10.1(b)(i), 10.1(b)(ii), and 10.1(b)(iii) either the Offeree or the Offeror does not submit the Offeree's Initial Counter Bid, the Offeree's Final Bid, the Offeror's Initial Counter Bid or the Offeror's Final Bid, as the case may be, in accordance with the procedures set forth in Sections 10.1(b)(i), 10.1(b)(ii), and 10.1(b)(iii), then the Member that delivered the last notice pursuant to such Sections will be obligated to consummate the purchase of all of the other Member's Interest at the price contained in the last notice.

10.2 Sale by Auction. If the procedures contained in Sections 10.1(a) are commenced but neither Member sends any notice pursuant to Section 10.1(b) following receipt of the Determined Value pursuant to Section 10.1(a), then the Member Interests will be sold according to the following procedures:

(a) the Firm selected pursuant to Section 10.1(a) will solicit bids (and the identity of the bidder and the amount of the bid will be made known to each Member when such bids are received) for the Member Interests of both the Members. The Offeror and the Offeree will be permitted to bid on the same basis as other

bidders;

(b) bids will be solicited for a period of 90 days from the date of the issuance by the Firm of its Determined Value;

(c) the Offeror and the Offeree will review each bid and will choose a bidder with whom to negotiate a definitive agreement. If the Offeror and the Offeree fail to choose a bidder with whom to negotiate a definitive agreement, the Offeror will review each bid and will choose a bidder with whom to negotiate a definitive agreement except (A) that if the Offeror or any of its affiliates has submitted a bid, then the Offeree will first determine whether the Offeror or its affiliates will be the bidder chosen with whom to negotiate a definitive agreement; if the Offeror is not chosen, then the Offeror will review each other bid and choose a bidder with whom to negotiate; and (B) that if both the Offeror and the Offeree or any of their affiliates have submitted bids, then the Offeree will first determine whether the Offeror or its affiliates will be the bidder chosen with whom to negotiate a definitive agreement; if the Offeror is not chosen, then the Offeror will review each other bid and choose a bidder with whom to negotiate. In that case in which a Member chooses a bidder with whom to negotiate, the choice will be made based upon the bid that represents the best overall value for the Member Interests. Each Member agrees that it will cooperate fully and in good faith in the negotiation of the definitive agreement with the bidder chosen pursuant to the procedures set forth herein;

(i) the foregoing notwithstanding, the sale of Member Interests may be consummated as a sale of assets and liabilities of the Company, if it is determined pursuant to the procedures provided for in this Section 10.2(c), that the sale would result in the best overall value; and

(ii) if there are any bidders not affiliated with the Offeror or the Offeree, then one of such non-affiliated bidders must be selected pursuant to Section 10.2(c)

above unless both the Offeror or the Offeree agree not to accept the bid.

10.3 *Closing*. The closing of the purchase and sale of any Member Interest pursuant to this Article 10 will be held at an acceptable place on an acceptable date (the ‘‘Buy-Sell Closing Date’’) not more than 90 days after the later of the receipt of the Offeror’s Initial Bid, the Offeree’s Initial Bid, the Offeree’s Initial Counter Bid, Offeror’s Initial Counter Bid, the Offeree’s Final Bid, the Offeror’s Final Bid or, if the Member Interests or Business are to be sold pursuant to Section 10.2, as provided in the definitive agreement entered into pursuant to that Section. At the closing, the party or parties selling the Member Interest or Interests will assign to the party that is purchasing the Member Interest or its designee all right, title and interest in the Member Interest, free and clear of all Encumbrances, and will execute such documents as may be necessary to effect the sale. The applicable purchase price will be payable by wire transfer of immediately available funds on the Buy-Sell Closing Date, except for a transaction consummated pursuant to Section 10.2, in which case the purchase price will be payable as provided in the definitive agreement entered into pursuant to that section.

Article 11: Buy-Sell upon Default

General Comment

This article sets forth the procedures for purchasing a Member’s Member Interest if the Non-Defaulting Member elects this remedy pursuant to Section 8.3 (Remedies—Upon Default by One Member) or as provided in Section 10.6 (Default by Purchasing Member).

A factor that might influence a Non-Defaulting Member to purchase the Member Interest of the Defaulting Member in any event might be the right to acquire the intellectual property rights held by the Company.

Care should be taken to review any agreements, contracts or other documents entered into by the Company that may contain restrictions on a change of control of the

Company, since the acquisition of a Member Interest may be interpreted as a change of control. It may even be that the change of control occurs when the notice of purchase is given, since it is at that time the Non-Defalting Member acquires the voting rights of the Defaulting Member. Ideally, this topic is successfully addressed at the time the Company enters into such contracts.

11.1 Generally. This Article applies if a Non-Defaulting Member has elected the provisions of either Section 8.3(a)(ii) (Right to Buy) or
8.3(a)(iii) (Right to Sell) and as provided in Section 10.6 (Default by Purchasing Member).

Comment

Article 11 applies only if a Non-Defaulting Member has elected to buy or sell in accordance with Section 8.3(a)(ii) or 8.3(a)(iii) or if the purchasing Member defaults on its purchase obligations under Article 10 (see Section 10.6). Because the Non-Defaulting Member may be selling, Section 11.2 first addresses the price to be paid for the Non-Defaulting Member's Member Interest.

11.2 Price—if Non-Defaulting Member's Member Interest is Being Purchased and Sold. The purchase price for a Non-Defaulting Member's Member Interest is 100% of the Fair Market Value of that Member Interest. ''Fair Market Value'' and ''Fair Market Value of the Company'' are each the highest price available for the Company in an open and unrestricted market between informed, prudent parties, acting at arms length and under no compulsion to act, expressed in terms of money or money's worth and will disregard any value that might be assigned by a purchaser with a special interest. The Fair Market Value of a Member's Member Interest is the amount determined by multiplying (a) the Fair Market Value of the Company by (b) the Member Interest of the Member.

Comment

Section 11.2 first establishes that a buy-out of a Member's Interest in a non-default circumstance is 100% of ''fair market value'' without any minority interest, lack of marketability or other discounts.

It then defines ‘‘fair market value’’ using the classic arm’s length standard. See Section 11.4 for resolution of disagreements as to fair market value. See also the commentary on Section 11.4 regarding directions that the Members may wish to provide to appraisers who are responsible for giving an opinion on fair market value.

11.3 Price—if Defaulting Member’s Member Interest is Being Purchased and Sold. The Purchase of the Defaulting Member’s Member Interest pursuant to a termination notice that elects that remedy pursuant to Section 8.3(a)(ii) (Right to Buy) will be at a price equal to 90% of the Fair Market Value of the Defaulting Member’s Member Interest. If there is a default described in Section 8.2 (Definitions—Defaulting Member and Non-Defaulting Member and Default Event), then the Non-Defaulting Member will suffer damages as a consequence of the default and the difference between the purchase price and the Fair Market Value of the Defaulting Member’s Member Interest will be regarded for all purposes as liquidated damages and not as a penalty.

Comment

Section 11.3 provides that a buy-out of a Member’s Interest in a default circumstance is at 90% of fair market value. The drafter alternatively might consider a price measured by the lesser of (a) a percentage of the fair market value or (b) a fraction of the Defaulting Member’s Book Capital Account.

The drafter should consider the enforceability of the right to purchase the Member Interest of the Defaulting Member for a price that is less than the fair market value. The provision has been drafted in an attempt to create an enforceable right by treating the discounted amount as liquidated damages, but it is not clear that the language that has been used to substantiate the discounted purchase price would be upheld by a court. See Comments to 8.3(a)(ii).

11.4 Resolution of Disagreement as to Amount.

(a) *Generally*. The recipient of the notice to purchase or sell that

specifies a Fair Market Value may object to the specified Fair Market Value by giving notice of objection (the ‘‘Notice of FMV Objection’’) to the Member giving notice within 15 days of its receipt. If a Notice of FMV Objection is given, each Member (i) will select a nationally or regionally recognized appraiser with experience in valuing businesses similar to that of the Company and (ii) will give notice to the other Member of its appraiser’s name and address. If either Member fails to appoint an appraiser and give notice to the other Member in accordance with this Section, the appraiser that was appointed by the other Member will determine the Fair Market Value of the Company.

(b) *Applicable Rules*. The appraisers will determine the Fair Market Value of the Company in accordance with the following:

(i) Each Member will cause the appraiser it selected to deliver to the other Member within 60 days of its selection its appraisal report and determination of the Fair Market Value of the Company.

(ii) If the lower appraisal is at least 90% of the higher appraisal, then the Fair Market Value of the Company will be the average of the two appraisals.

(iii) If the lower appraisal is less than 90% of the higher appraisal and if neither Member objects within 30 days after its receipt of the appraisal from the other Member, then the Fair Market Value of the Company will be the average of the two appraisals. If the lower appraisal is less than 90% of the higher appraisal and if either Member objects within 30 days after its receipt of the appraisal from the other Member, then the Members will cause the two appraisers to appoint a third appraiser who satisfies the requirements of Section 11.4(a). If the two appraisers cannot agree upon a third appraiser within ten days following receipt by the appraisers of notice requesting that they appoint the third appraiser, then either of the Members may apply to have the third appraiser selected by the American Arbitration Association from its panel of appraisers.

(iv) Within 60 days after the appointment of the third appraiser, the third appraiser will deliver to each Member an appraisal report that sets out the appraiser's determination of the Fair Market Value of the Company, together with an analysis of how it determined that Fair Market Value.

(v) If a third appraiser is appointed, the Fair Market Value of the Company will be the value determined by the one of the first two appraisers whose value determination was closest to that determined by the third appraiser. However, if the third appraiser's determination is within 10% of the average of the first two appraisals, whether higher or lower, then the average of the first two appraisals will be the value that is used.

(vi) Subject only to signing a confidentiality agreement that is in form and substance customary at that time for appraisers, each appraiser will be granted unrestricted access to the books and records of the Company, the Facility and the employees of the Company as well as to the employees of the Members having information about the Company.

(vii) Each Member will pay the fees and expenses of the appraiser it appoints. The Member whose appraiser's valuation was not used will pay the cost of any third appraiser; *provided, however*, that if the average of the first two appraisals is used pursuant to Section 11.4(b)(v), then the Members will bear equally the fees and expenses of the third appraiser.

Comment

The Model JV Agreement requires that the Non-Defaulting Member state the fair market value of the Defaulting Member's Member Interest and provides for an appraisal procedure of the fair market value of the Company if the Members do not agree to the stated fair market value. Section 11.4 contemplates two appraisers, with a third if the first two are not within 10% of each other. Section 11.4 also defines the standards that appraisers must meet and sets forth certain

procedures.

The method provided to resolve disputes over fair market value is one of many that could be used.

Regardless of the procedure, the Members must keep in mind that valuations are dependent upon the respective weighting that each appraiser gives to the facts and the applicable theory in each case. Consequently, reputable appraisers appraising the same business may differ substantially in their value determinations. The suggested use of two or three appraisers is an attempt to balance the effect of the approaches used by different appraisers.

The valuation process is expensive. If the intrinsic value of the business is not substantial, the Members may wish to minimize the cost of the valuation process by using only one appraiser and risk getting an appraisal that may not match the fair market value expectations of either or both Members.

The Members may wish to add further direction to the appraisers. The Members could direct the appraisers (1) to ignore the event giving rise to the appraisal—i.e., the default of one of the Members—and then have that deducted against what the Defaulting Member receives, or (2) to take that event into account. If there are any special considerations that are applicable to the business, these should be identified, and the Members should consider whether the appraisers should be required to take these circumstances into account. For example, in the Fact Pattern, during the early stages, a portion of the distribution of the product is marketed through Large Member's network of independent agents. If Large Member is a seller under these provisions, those distributors may be hostile to Small Member. Should the fact that Small Member will be reliant upon these distributors be a factor that the appraisers should be directed to take into account?

The appraisers may be independent business appraisers, appraisers from a reputable firm of public accountants, or they may be chosen from a national firm of investment

bankers. As a further option, in the same manner as provided for the selction of the third appraiser the selection may be made by an organization such as the American Arbitration Association from its list of appraisers.

The drafter also should note that if the procedure for determining an independent valuation runs its full course, it could take up to six months. Fair market value can change considerably during that period, and the drafter should therefore consider a fixed reference date for determining fair market value. Further, it may not be commercially feasible for two co-venturers who have become unwilling participants to remain as co-venturers for such a long period of time after the buy-sell provisions of this Article have been initiated.

11.5 Default Buy-Sell Closing—Generally. The closing (the ‘‘Default Buy-Sell Closing’’) of the purchase and sale of the selling Member’s Member Interest will take place on the 60th day following the date on which the parties are given notice that the Fair Market Value has been determined in accordance with this Article 11, or, if that day is not a Business Day, on the next following Business Day (the ‘‘Default Buy-Sell Closing Date’’). The Default Buy-Sell Closing Date will be extended to the extent necessary for either Member to secure any required governmental approval or consent to a date five Business Days following the approval or consent so long as the Member is using its Best Efforts to pursue the approval or consent and every 30 days during the extension delivers to the other Member a certificate that such approval is being so pursued. For purposes of this provision, ‘‘governmental approval or consent’’ includes expiration of the Hart-Scott-Rodino waiting period and similar merger control provisions that do not constitute formal approvals or consents. The Default Buy-Sell Closing will take place at 11:00 AM on the Default Buy-Sell Closing Date at the offices of the lawyers for the Company (or, if there are none, at the offices of the lawyers for the purchasing Member).

Comment

The selection of the closing date should provide the buyer with adequate time to

permit it to secure the required funding. Since the purchase price will not be known until the completion of the last valuation, the closing should be keyed from that date. The period between the time the Non-Defaulting Member gives notice of purchase to the Defaulting Member and the date of closing is a very sensitive period. The Non-Defaulting Member must move quickly to assume all of the operational aspects of the Company's business and its functions, including control of books and records, bank accounts and employees. In that regard, care must be taken to provide the Non-Defaulting Member with those rights. For example, see the provision regarding control of the Management Committee in Section 8.3(c)(Management Changes). If a Member is a Defaulting Member, it will resist the granting of rights to the Non-Defaulting Member to manage the Company while the valuation is proceeding. In many LLCs, there is no segregation of management functions from those of the members. In that case it may be adequate to provide for an immediate right of control for the Non-Defaulting Member, augmented by such specific examples as the particular facts may warrant.

11.6 Default Buy-Sell Closing—Selling Member Deliveries. At the Default Buy-Sell Closing, the selling Member will deliver to the purchasing Member the following executed documentation, in form reasonably acceptable to the purchasing Member:

(a) an assignment of the certificate for its Member Interest to the purchasing Member or its designee;

(b) the resignation of each of its designees who are acting as Managers or Officers of the Company;

(c) a representation and warranty by the Member that its Member Interest and all indebtedness owed to it by the Company are free and clear of all Encumbrances, which representation and warranty will survive the Default Buy-Sell Closing and will continue indefinitely;

(d) a general release of all claims against the Company and the purchasing Member relating to Company matters;

(e) if the selling Member is the licensor under the Technology License Agreement between the selling Member and the Company, an agreement extending the term of the Technology License Agreement for at least five years from the Default Buy-Sell Closing Date;

(f) if the Company will be dissolved by reason of the purchase of the selling Member's Member Interest, then the selling Member's consent, if necessary, to the assignment to the purchasing Member of the Company's rights under the Technology License Agreement between the selling Member and the Company; and

(g) such other documentation as the purchasing Member may reasonably require in order to vest in the purchasing Member or its designee full right, title and interest in and to the Member Interest of the selling Member free and clear of all Encumbrances.

Comment

This Section sets forth the selling Member's deliveries at the closing.

Note in particular Section 11.6(f), involving the consent to any transfer of the Technology License Agreement. The drafter needs to consider carefully whether any other consents or deliveries are appropriate, rather than relying solely on the general ''catch all'' of Section 11.6(g).

11.7 Default Buy-Sell Closing—Purchasing Member Deliveries. At the Default Buy-Sell Closing, the purchasing Member will deliver to the selling Member:

(a) *Purchase Price*. The purchase price in immediately available funds, subject to the following and Section 11.8:

(i) *Installment Payments of Purchase Price*. If the purchase and sale is pursuant to any provision other than Section 8.3(a)(iii) (Right to Sell), then the purchasing Member may pay the purchase price in 20 equal quarterly installments, commencing on the first day of the first calendar quarter following the Default Buy-Sell Closing and continuing on each

first day of the next 19 calendar quarters. The obligation will be evidenced by a promissory note bearing interest on any unpaid principal and (if permitted by Applicable Law) any interest not paid when due at a fluctuating rate equal to 75% of the Specified Interest Rate (but not in excess of any legally permitted rate of interest). The obligation will be nonrecourse as to the other Member.

(ii) *Debt to Company*. If the selling Member owes money to the Company, then the purchase price will be reduced by the amount of the principal and accrued but unpaid interest of that indebtedness.

(iii) *Debt to Selling Member*. If the Company owes money to the selling Member, then the Company will pay to the selling Member the full amount of the principal and accrued but unpaid interest of that indebtedness at the Default Buy-Sell Closing.

(iv) *Installment Payments of Debt*. If the purchase price could be paid in installments pursuant to Section 11.7(a)(i), then any payments pursuant to Section 11.7(a)(iii) may be made in installments as provided in Section 11.7(a)(i).

(b) *Other*. The following executed documentation in form reasonably acceptable to the selling Member:

(i) *Indemnity*: an indemnity indemnifying the selling Member against any claims arising from the conduct of the business of the Company from and after the Default Buy-Sell Closing Date and with respect to Encumbrances assumed by the purchasing Member pursuant to Section 11.8 that have reduced the amount payable to the selling Member; and

(ii) *Release*: a general release of all claims against the selling Member by the Company and the purchasing Member relating to Company matters except for (A) claims arising from the unauthorized actions of the selling Member in respect of the Company that have not been disclosed to the purchasing Member, (B) a breach by the selling Member of any representation, warranty, covenant or agreement related to or contained in any document it delivered pursuant to Section 11.6, and (C) the continuing obligation of the selling Member under Article 15 (Competition) and Article 16 (Confidentiality).

Comment

This Section sets forth the purchasing Member's deliveries at the closing.

Section 11.7(a)(i) sets forth the circumstances in which the purchase price can be paid in installments.

Section 11.7(a)(ii) and (a)(iii) address the treatment of indebtedness to or from the selling Member.

The Non-Defaulting Member may be reluctant to release the Defaulting Member from all claims. It may be more appropriate for the Members to agree simply to buy and sell the Member Interest and preserve any rights each of them may have against the other. However, the absence of a release could impact the analysis of whether a purchase price that is less than the Fair Market Value is enforceable (See Section 11.3 and the Comment to it).

If releases are to be provided, the drafter should consider if it is necessary or desirable to obtain releases from the Defaulting Member's designees as well.

The Members may also wish to include a provision that provides for a valuation of the Defaulting Member's loans or advances to the Company. The Model JV Agreement addresses only the net amount of indebtedness between the Defaulting Member and the Company. There is no attempt to determine if the Company is capable of paying these amounts in full. If the assets of the Company are worth less than its liabilities, then the value of the indebtedness to a Member would be worth less than its face amount.

A Non-Defaulting Member may wish to include a provision in the contract providing for the escrow of a part of the purchase price for some time after closing if claims arise against the Member Interest transferred by the Defaulting Member.

The purchase that is occurring is not a co-operative event; rather it is taking place because of the default of one of the Members. Therefore, the drafting is

reflective of the extreme reluctance of a seller to give anything more by way of representations, warranties, covenants or even documentation than is absolutely necessary, even though a buyer will be seeking as comprehensive a set of rights as possible. Since the Model JV Agreement is being drafted at a time when these issues are only anticipatory, it will be easier to settle on broader provisions than would be the case if the Members were negotiating the issues after a default had taken place.

11.8 Default Buy-Sell Closing—Claims against Purchased Member Interest. If the Member Interest of the selling Member is not free of all Encumbrances at the Default Buy-Sell Closing, then: (a) the purchasing Member may, without prejudice to any other rights that it may have, purchase the Member Interest of the selling Member subject to those Encumbrances; and (b) in that event, at the Default Buy-Sell Closing (i) the purchasing Member will assume all obligations and liabilities with respect to those Encumbrances and (ii) the amount to be paid to the selling Member will be reduced by the maximum amount secured by the assumed Encumbrances.

11.9 Default Buy-Sell Closing—Default by Selling Member. If the selling Member does not deliver at the Default Buy-Sell Closing the documents required to be delivered by it pursuant to this Agreement, then the purchasing Member may, if not in default under this Agreement, without prejudice to any other rights that it may have, either:

(a) by notice to the selling Member, cancel the purchase and elect to dissolve the Company in accordance with Section 8.3(a)(i) (Dissolution), or

(b) pay the amount payable to the selling Member to an account for the credit of the selling Member at the Company's bank. From and after the date of payment (or if there is no amount owed to the selling Member, then from and after the Default Buy-Sell Closing at which the purchasing Member tenders all documents that it is required to tender at the Default Buy-Sell Closing): (i) all rights, both at law and in equity, in and to the selling Member's Member Interest will be deemed to have been assigned to and vested in the

purchasing Member and the selling Member will have no further rights in it and (ii) the purchasing Member will have the right to execute and deliver, on behalf of and in the name of the selling Member, such deeds, assignments, transfers, resignations, releases or other documents that may be necessary or desirable to complete the purchase of the selling Member's Member Interest. Each of the Members hereby irrevocably appoints the other as its lawful attorney-in-fact and agent for such matters. The appointment is coupled with an interest, will not be revoked by the dissolution, winding-up, bankruptcy or insolvency of the selling Member, and each Member hereby ratifies and confirms all that the purchasing Member may lawfully do or cause to be done by virtue of this Section
11.9(b).

Comment

It is the intent of this section to permit the purchasing Member to acquire the Member Interest of the selling Member, together with all rights thereto, should the purchasing Member be entitled to such interest pursuant to the terms of the Model JV Agreement and to avoid having that transfer disrupted by the failure of the selling Member to cooperate.

DLLCA § 18–306 specifically permits the agreement to provide (1) remedies for a member who fails to perform or comply with the terms of the agreement or (2) specific penalties or specific consequences upon the happening of specific events. Pursuant to DLLCA § 18-502(c), these specific penalties and consequences may include a forced sale or forfeiture of the Member Interest.

In the event of a default by the selling Member to deliver the documents required to transfer its Member Interest, Section 11.9 authorizes the purchasing Member to either (1) dissolve the Company or (2) pay the amount owed to the selling Member, and thereafter, the selling Member's Member Interest is deemed vested in the purchasing Member, together with all associated rights.

Section 11.9 further gives the purchasing Member in this situation the power to

execute the necessary documents on behalf of the selling Member to accomplish the transfer and names the purchasing Member as the selling Member's attorney-in-fact and agent for those purposes.

Article 12: Reporting and Accounting Provisions

General Comment

This Article sets forth the Company's basic record keeping obligations and also its obligations as to reports to the Members.

While these provisions are usually not heavily negotiated, each Member needs to assure itself that it will be getting the basic information it needs. Of course, its representatives on the Management Committee will have access to additional information, and Section 12.4 grants broad rights of inspection and examination.

12.1 Books and Records. The Company will make and keep books, records and accounts that, in reasonable detail, accurately and fairly reflect in all material respects the assets, liabilities and operations of the Company. The Company will also maintain a system of internal accounting controls that complies with Applicable Law and that will provide reasonable assurance that:

(a) transactions are executed in accordance with the Management Committee's general or specific authorization;

(b) transactions are recorded as necessary (i) to permit preparation of financial statements in conformity with GAAP or any other criteria applicable to the statements and (ii) to maintain accountability for assets;

(c) access to assets is permitted only in accordance with manage-ment's general or specific authorization; and

(d) the recorded accountability for assets is compared with existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

Comment

This provision is a close paraphrase of Exchange Act § 13(b)(2), 15 USC § 78m

(b)(2), which was added by the Foreign Corrupt Practices Act of 1977. In the public company context, the Sarbanes-Oxley Act may require additional provisions. In any case, other legal and ‘‘best practices’’ requirements should be reviewed.

12.2 Other Accounting and Tax Provisions. Attachment 12 (Tax) contains additional accounting and tax provisions applicable to the Company.

Comment

More detailed accounting and tax provisions are included as an attachment and not in the main text to unclutter the main text and make it easier to use.

The tax treatment of joint ventures is beyond the scope of this project—except to remind the drafter of the importance of getting tax input early in the process.

12.3 Distribution of Financial Statements and Other Reports. The Company will distribute to each Member:

(a) *Monthly Information*. As soon as practical and in any event within [10] Business Days following the last day of each month,

(i) a statement of the Company’s: (A) cash; (B) working capital; (C) obligations for borrowed money; (D) revenue; (E) backlog; (F) head-count; and (G) [_____]; and

(ii) a summary of any transaction or contract involving an obligation in excess of $ _____.

(b) *Quarterly Information*. As soon as practical after the end of each of the first three quarterly periods and in any event within 30 days after the end of each period, a balance sheet as of the end of the period and statements of income and cash flow, both for the period and for the year to date, that will be certified by the CFO as fairly presenting in all material respects the Company’s financial position as of that date and the results of its operations for those periods in accordance with GAAP (subject to normal year-end adjustments and the furnishing of notes; *provided*, *however*, that notes will be furnished to the extent necessary to make the statements not misleading);

(c) *Annual Information*. As soon as practical after the end of the Fiscal Year and in any event within 60 days thereafter:

(i) a balance sheet as of the year-end and statements of income and cash flow, both for the fourth quarter and for the year; and

(ii) the Company's tax return, which will be reviewed by its independent certified public accountants, and information that will be required to permit the Member to prepare its tax return.

The year-end balance sheet and the statements for the year will be examined in accordance with generally accepted auditing standards by the Company's independent certified public accountants, who will render their opinion on whether those statements fairly present in all material respects the Company's financial position as of that date and the results of its operations for those periods in accordance with GAAP.

Comment

Reports delivered to the Members should include relevant items drawn from the Business Plan.

12.4 Right of Inspection and Examination. At all reasonable times, each Member, through its representatives, has the right to inspect and copy the records of the Company and to examine the employees of the Company with regard to its activities. These rights may be exercised through any agent or employee of the Member designated by notice to the CEO. The inspecting Member will bear all expenses incurred in the inspection or examination.

12.5 Auditors. The initial auditors of the Company are _____.

Article 13: Dispute Resolution

General Comment

CAVEAT: The dispute resolution provisions in the Model JV Agreement reflect only one of many approaches and are included solely to raise issues that the drafter should consider in the joint venture context. Otherwise, a review of alternative dispute

resolution is beyond the scope of this publication. A detailed discussion of dispute resolution provisions can be found in *Commercial Arbitration at Its Best: Successful Strategies for Business Users* (Thomas J. Stipanowich & Peter H. Kaskell, eds. 2001) published by the American Bar Association Sections of Business Law and Dispute Resolution and the CPR Institute for Dispute Resolution and other sources.

Article 13 of the Model JV Agreement provides for disputes of a ‘‘legal’’ nature to be resolved by means other than litigation. This assumes the Members believe that negotiation, mediation, and ultimately binding arbitration of legal disputes would be less costly and time-consuming, or for other reasons, more advantageous than resolving the disputes through litigation.

This Article is not intended to provide a procedure for resolving business disputes, which are covered extensively in Section 5.9 (Dispute Resolution Procedures) and if those procedures do not succeed, by Article 7 (Dissolution or Buy-Sell—In the Absence of Default) and more specifically Section 7.2(b) (Unresolved Business Dispute). This assumes that the Members conclude that disagreements over business issues (whether or how to change the Company’s business plan, whether additional members should be added, what the Company’s business is worth, etc.) should not be subject to binding arbitration. Business people typically are reluctant to allow an arbitrator to rule on a business issue on which they themselves cannot agree. Arbitrators often are viewed as trained in the law but not possessing the same level of business acumen as the Members themselves have. Thus, Section 13.1 makes clear that the alternative dispute resolution (ADR) procedures of Section 13.2 apply only to instances of default in ‘‘legal’’ claims—involving contractual or other legal obligations. Similarly, disputes as to ‘‘Fair Market Value’’ under the buy-sell provisions of Article 11 are subject to the resolution procedures of Section

11.4 (Reolution of Disagreement as to Amount), and not those in this Article 13.

Requests for injunctive or other equitable relief may be brought under Section

17.3 (Jurisdiction; Service of Process).

13.1 Generally.

(a) *Applies Only to Legal Claims.* This Article 13 governs only those disputes that arise under this Agreement, the outcome of which depends solely on whether the Company, a Member or any of its Affiliates is in default of its contractual or other legal obligations (a ‘‘Legal Claim’’). ‘‘Legal Claims’’ include (i) disputes as to indemnification under Article 14 (Indemnification) or any of the Related Agreements and (ii) the formation, validity, binding effect, applicability, scope, interpretation, performance, breach or termination of this Agreement or any Related Agreement.

(b) *Matters Specifically Not Subject to Article 13 Dispute Resolution Procedures*. Without limiting Section 13.1(a):

(i) *Business Disputes*: any dispute regarding a matter listed in Section 5.4 (Actions Requiring Management Committee Approval—Major) is not considered a Legal Claim subject to resolution under Section 13.2 but will be subject instead to Section 5.9 (Dispute Resolution Procedures);

(ii) *Fair Market Value*: a dispute as to ‘‘Fair Market Value’’ under Article 11 (Buy-Sell Upon Default) is not considered a Legal Claim subject to resolution under Section 13.2 but is subject instead to Section 11.4 (Resolution of Disagreement as to Amount); and

(iii) *Injunctive Relief*: requests for injunctive or other equitable relief may be brought under Section 17.3 (Jurisdiction; Service of Process).

Comment

Section 13.1 indicates that legal claims will be subject to the ADR procedures of Section 13.2, regardless of whether they arise under the joint venture agreement itself or one of the Related Agreements (such as an intellectual property license agreement or a toll manufacturing contract). The Members might decide instead to revise this Section to apply the ADR procedures only to disputes under the

joint venture agreement, and to incorporate separate (or no) ADR procedures in the Related Agreements. More typically, however, joint venturers consider the Related Agreements to be an inseparable part of the joint venture arrangement and, therefore, wish to have one set of ADR procedures (including a common choice of law provision) that extends to all agreements involving the joint venture. If so, the drafter of the Related Agreements probably will wish to include in those agreements a reference to the fact that all disputes are subject to resolution under this Article 13.

13.2 Dispute Resolution Procedures

(a) *Negotiation*. Either Member may give notice of a Legal Claim to the other Member. For a period of 30 days from receipt of the notice, the Members will consult with each other in a good faith effort to resolve the Legal Claim.

(b) *Mediation.* If the Members do not settle the Legal Claim within the 30 days, either Member may provide the other Member with a notice for mediation. After delivery of that notice, the Members will attempt in good faith to settle the matter by mediation administered by the [*name of source of the mediators*] under its [*specify mediation rules that are to apply*].

(c) *Binding Arbitration*. If within 30 days after receipt of the notice for mediation, the mediation does not result in settlement of the Legal Claim, then the Legal Claim will be finally resolved by arbitration administered by the American Arbitration Association, in accordance with [*specify arbitration rules that are to apply*]. A Member may initiate arbitration by notice to the other Member any time after expiration of 60 days from receipt of notice of the Legal Claim provided for in Section 13.2(a), whether or not mediation has been initiated or completed unless the mediation was completed by agreement of the parties [and all issues resolved] as reflected in a written agreement. Unless the Members agree otherwise, initiation of arbitration will not relieve any Member of its obligation to participate in any mediation initiated under Section 13.2(b).

(d) *Arbitration Terms*. Any arbitration will comply with the following terms:

(i) *Formation of Tribunal*. The arbitration tribunal will consist of three arbitrators. One arbitrator will be appointed by each Member and the third will be appointed by the first two. If the first two arbitrators fail to agree on the third arbitrator within 30 days after their appointment, the third arbitrator will be appointed by the American Arbitration Association.

The arbitrators will be familiar with the commercial and manufacturing practices of the _____ industry.

(ii) *Conduct of Arbitration*. The arbitration will take place in and will exclude any right of application or appeal to any court in connection with any question of law or fact arising in the course of the arbitration or with respect to any award made. The United States Arbitration Act (9 U.S.C. §§ 1–16, 201–208, 301–302) will apply and the arbitrators will otherwise apply the law specified in Section 17.11 (Governing Law).

(iii) *Awards*. The arbitration award will be final and binding on the Members, will not be subject to judicial appeal, will not include any punitive damages and will deal with the allocation of costs of arbitration, including legal fees and all related matters. Any monetary award will stipulate a rate of interest, deemed appropriate by the arbitrators, which will run from the date notice of Legal Claim was given until the date when the award is fully satisfied. The arbitration award will be promptly satisfied by the Member against whom it is granted, free of any deduction or offset. Any cost or fee incident to enforcing the award will, to the maximum extent permitted by law, be charged against the Member resisting enforcement. Judgment upon the award rendered may be entered in any court having jurisdiction, or application may be made to that court for a judicial recognition of the award or an order of enforcement thereof, as applicable. The Company or any Member may bring an action to enforce any award granted under this Section 13.2.

Comment

Section 13.2(a) requires the Members to consult with each other in a ‘‘good

faith'' effort to settle Legal Claims.

Section 13.2(a) requires the Members to consult with each other in a ''good faith'' effort to settle Legal Claims. The drafter rightfully may ask what obligations are imposed by a ''good faith'' requirement. Several points regarding the DLLCA and ''good faith'' are worth noting in this regard:

- The ''good faith'' commitment reference in Section 13.2(a) is not intended to create any obligations beyond the implied contractual covenant of good faith and fair dealing referenced in DLLCA § 18–1101(c).
- Under DLLCA § 18–1101(c), the implied covenant of good faith and fair dealing may not be eliminated, although members, by agreement, may otherwise expand, restrict or eliminate the duties of a member or manager or other persons, including fiduciary duties.
- Likewise, DLLCA § 18–1101(e) provides that ''liabilities for breach of contract and breach of duties (including fiduciary duties) of a member, manager or other person'' may be limited or eliminated, although they ''may not limit or eliminate liability of any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith.''
- Under rules of contract construction, it is reasonable to expect that the general obligation of good faith and fair dealing would not be interpreted to contravene any specific modifications made in the Model JV Agreement [Section 5.10(b)] to the duty of loyalty imposed by ULLCA § 409(b).

A review of legal literature will lead one quickly to conclude that the concept of good faith has been discussed for many years, without any consensus as to its general meaning. *See* Restatement of Contracts Second § 205. For essentially the same reasons, the Model JV Agreement does not define ''good faith.'' If warranted

by the circumstances of a particular transaction, of course, the drafter may wish to consider tailoring a definition suited to those circumstances, but in a manner consistent with DLLCA § 18–1101.

The Members would be well advised to agree in advance on the source(s) of the mediators and arbitrators (such as the CPR International Institute for Conflict Prevention and Resolution or the American Arbitration Association) and on the procedural rules to be applied by the mediators/arbitrators. Which sources to use and which rules to apply are complex subjects that are beyond the scope of this commentary. The Members should also satisfy themselves that the particular ADR provisions they incorporate in their agreements will provide both a fair and efficient alternative to litigation. Also, they might wish to consider whether the rules adequately address pre-hearing exchanges of information, oral presentations to the arbitrator, the scope of submissions, use of experts, whether the arbitrator's report must be written and include a rationale, etc.

The wording of Section 13.2(d) is designed to induce the Members to agree where any arbitration would be held.

The provision indicating that the Federal Arbitration Act will apply to arbitrations under the Model JV Agreement is designed to preempt any state legislation that otherwise may undermine the Members' intention to make arbitration the exclusive means of finally resolving legal disputes (see ''Pre-emption by Federal Arbitration Act (9 USCS §§ 1 et seq.) of state laws prohibiting or restricting formation or enforcement of arbitration agreements,'' 108 A.L.R. Fed 179 (1992)) and numerous case annotations on this subject following Section 2 of the Federal Arbitration Act, 9 U.S.C.A. § 2.

Article 14: Indemnification

General Comment

This Article 14 provides for broad indemnification by each Member both (1) for

breaches of representations and warranties or covenants made as part of the joint venture agreement and (2) for damages suffered as a result of other specified matters.

Although the inaccuracy of a representation that survives the Closing or the breach of a covenant may give rise to a claim for damages for breach of the agreement without any express indemnification provision, it is customary in the acquisition of assets of a privately held company for the buyer to be given a clearly specified right of indemnification for breaches of representations, warranties, covenants, and for certain other liabilities. In this context, the formation aspects of the joint venture agreement are analogous to an acquisition agreement in that assets are being transferred to a separate entity for the benefit of the joint venture members.

Although the inclusion of indemnification provisions in acquisition agreements is ‘‘standard,’’ there is no such thing as a set of ‘‘standard’’ indemnification provisions. In practice, the scope and details of the indemnification provisions are usually the subject of intense negotiation. In addition, the negotiation of indemnification clauses may proceed differently in the context of a joint venture where the provisions are likely to be reciprocal and the joint venturers have to work together post-Closing, as opposed to an acquisition agreement where the seller is usually not involved post-Closing. In the joint venture context, the indemnification provisions will also need to be adjusted to address risks associated with the nature of the joint venturers’ businesses and their respective past manner of operation.

In agreements where indemnification provisions are included, there is a standard set of issues to be dealt with: First, the standard indemnity for breaches of representations and warranties and failure to observe covenants. Second, indemnification provisions may also provide for recovery for specific matters, most commonly regarding tax and environmental matters, even though the damages are not based on a breach of any representation or warranty. Thus, in the Model JV Agreement, Sections 14. 2 and 14.4 impose indemnification obligations on the Large Member and Small Member,

respectively, for (1) breaches of representations and warranties and covenants made as part of the Model JV Agreement and (2) in subsection (c) of each, with respect to liabilities of either Member that are not expressly assumed by the Company. Also, Section

14.3 imposes indemnification obligations on Large Member for damages suffered as a result of environmental matters, that is not based on a breach of a representation or warranty.

Another reason for an indemnity is that it extends protection to more than just the contracting parties (including, for example, the Company and representatives and owners of the Members).

The inclusion of indemnification provisions also permits the Members to agree in advance on specific limitations and rights with respect to indemnification claims that might not be applicable under the law of remedies. These include the deductible in Section

14.5, the time limitations in Section 14.6, and the rights of the indemnifying Member to defend third party claims in Section 14.7.

Other rationales for indemnifications are that, unless otherwise provided by agreement, indemnification obligations are not usually offset or diminished by collateral benefits that the indemnified party may receive as a result of suffering a loss, such as insurance proceeds or tax benefits. (See the comments to Section 14.2.)

Finally, Section 14.10 provides that, except with respect to certain provisions, and subject to following certain procedures, the remedies provided in Article 14 are the sole and exclusive remedies available with respect to inaccuracies and to breaches of a Member's representations and warranties.

14.1 Survival; Effect of Knowledge; Other.

(a) *Survival*. Each representation, warranty, covenant and agreement in this Agreement, and in any certificate or document delivered pursuant to this Agreement,

survives the Applicable Closing only (i) for the time periods specified in Section 14.6 and (ii) as to claims made within those time periods, until resolved. ‘‘Applicable Closing’’ means, as applicable, the Closing in Section 2.8 (Closing Deliveries) and each subsequent transfer of cash or property pursuant to Section 3.2 (Additional Capital Contributions and Member Loans).

Comment

Section 14.1 provides that the joint venturers’ representations, warranties, covenants and agreements contained in the Model JV Agreement survive the Applicable Closing and are thus available as the basis for post-Closing monetary remedies.

In the joint venture context, the term of the venture may extend beyond normal statute of limitations periods or beyond customary limitations on the survival of representations and warranties. Consideration should be given to the particular circumstances of the joint venturers as to what specific (if any) limitations on survival of representations and warranties should be negotiated. It is common in many acquisition agreements to include an express survival clause (and, as noted in the General Comment to this Article 14, the initial transaction in the joint venture context is no different from an acquisition in that assets are being transferred to a separate entity for the benefit of the joint venture members) to avoid the possibility that a court might import the real property law principle of obligations merging in the delivery of a deed and hold that the representations merge with the Closing of the creation of the joint venture and, thus, cannot form the basis of a remedy after the Closing. Cf. *Business Acquisitions* Ch. 31, at 1279–80 (Herz & Baller eds., 2d ed. 1981). Such a survival clause has been included in Section 14.1.

(b) *Effect of Knowledge.*

(i) *Bar if Undisclosed Prior Knowledge of Material Breach.* Large Member

Indemnified Persons will not be indemnified pursuant to this Article 14 for breaches of representations, warranties, covenants and agreements in this Agreement or in any certificate or document delivered pursuant to this Agreement to the extent that *[specify name of the due diligence team leader for the Large Member]* had Undisclosed Prior Knowledge of Material Breach before the Applicable Closing, and the Small Member Indemnified Persons will not be indemnified pursuant to this Article to the extent that *[specify name of the due diligence team leader for the Small Member]* had Undisclosed Prior Knowledge of Material Breach before the Applicable Closing. ‘‘Undisclosed Prior Knowledge of Material Breach’’ means that the Person with respect to whom the term is used (A) had actual knowledge of acts, omissions, facts or circumstances that such Person had concluded constituted a breach of the other Member’s representations, warranties, covenants or agreements in this Agreement or in any certificate or document delivered pursuant to this Agreement that could reasonably be expected to be the basis for an indemnification claim pursuant to this Article 14 in excess of $ _____ and (B) did not advise the other Member of that breach before the Applicable Closing. The foregoing does not apply to matters specifically indemnified in Section 14.2(c), 14.3 or 14.4(c).

(ii) *Exception.* Except as specifically provided in Section 14.1(b)(i):

(A) the right to indemnification based upon representations, warranties, covenants and agreements in this Agreement and in any certificate or document delivered pursuant to this Agreement will not be affected by any investigation or by any Knowledge acquired at any time; and (B) thus if a Member proceeds to close, even though it has Knowledge as to the accuracy or inaccuracy of or non-compliance with any such representation, warranty, covenant or agreement not covered by Section 14.1(b)(i), then the Member will be entitled to indemnification under this Article.

Comment

Knowledge is a basic issue in indemnification provisions and it is one as to which there is no ‘‘correct’’ answer. Section 14.1(b) provides that an

indemnifying Member (Member A) has no obligation to indemnify the other Member (Member B) to the extent that it can prove that Member B had actual knowledge of acts, omissions, facts or circumstances that it had concluded constituted a material breach by Member A of which Member B did not advise Member A before the Applicable Closing. This approach differs from the approach used in the *Model Asset Purchase Agreement with Commentary* and the *Model Stock Purchase Agreement with Commentary*, which provide that Member B's knowledge of the inaccuracy is not a defense that can be used by Member A to a claim for indemnity. The approach taken in the *Model Asset Purchase Agreement with Commentary* and the *Model Stock Purchase Agreement with Commentary* permits a buyer to assert an indemnification claim not only for inaccuracies first discovered after the Closing but also for inaccuracies disclosed or discovered before the Closing. The approach to be taken in the joint venture context is generally the subject of considerable debate. Member A may argue that Member B should be required to disclose a known breach of Member A's representations before the Closing and waive it, renegotiate the terms of the deal, or refuse to close. Member B may respond that (a) it is entitled to rely upon the representations made when the joint venture agreement was signed, which, presumably, were taken into account in Member B's decision to enter into the joint venture and (b) that Member A should not be able to limit Member B's options to waiving the breach, renegotiating the deal or terminating the agreement and suing for damages. Member B can argue that the representations and the related right to indemnification are part of the consideration for entering into the transaction and that it is entitled to indemnification for an inaccuracy in those representations, regardless of Member B's knowledge.

The Model JV Agreement contains a hybrid, inasmuch as it permits Member B's

knowledge to be a defense to Member A's obligation to indemnify, but *only* where that knowledge was both of a material breach (stated as a dollar amount) and was not disclosed by Member B prior to the Applicable Closing. **This approach has been adopted not because the drafters of the Model JV Agreement necessarily believe it is the appropriate result in all situations, but rather in order to highlight the issue**.

The basic argument supporting this approach is that it would be inconsistent with the concept of an ongoing relationship to provide for the possibility of a Member asserting a post-Closing claim for indemnity, when the claiming Member knowingly did not raise, in advance of Closing, the other Member's breach. There is no question that premitting a defense based upon Member B's knowledge could convert each claim for indemnification into an extensive discovery inquiry into the state of Member B's knowledge and, in the formulation in Section 14.1, the timing of becoming aware of the information. Such burdens clearly reduce the effectiveness of indemnification as a remedy and need to be balanced against the need for candor and openness between parties forming a joint venture.

If Member B is willing to accept some limitation on its entitlement to indemnification based upon its knowledge, it should carefully define the circumstances in which knowledge is to have this effect. For example, the joint venture agreement could distinguish among knowledge that Member B had before signing the joint venture agreement, knowledge subsequently acquired through Member B's pre-Closing investigation, and knowledge resulting from Member A's pre-Closing disclosures.

The Model JV Agreement provides that if Member B had actual knowledge (i.e. that Member B's due diligence team leader had that knowledge) of a material breach (stated as a dollar amount) and that it did not advise Member A before the Applicable Closing and Member B nevertheless proceeds to close the transaction, Member B loses its right to indemnification for that particular breach. Instead of limiting this

knowledge to the applicable Member's due diligence team leader, this provision could be expanded to include specified officers of the applicable Member whose knowledge is relevant for purposes of this determination.

Some courts have addressed the extent to which knowledge may be a bar to a claim for a breach of a representation and warranty, even if there is no express language addressing the effect of knowledge in the agreement. Because justifiable reliance is a critical element of a valid claim for breach, these courts have based their decision generally on the grounds that the party making the claim had knowledge of the breach and could not have justifiably relied on the representation and warranty. Thus, one increasingly sees matters of concern addressed by specific indemnities, such as those in Sections 14.2(c), 14.3 and 14.4(c). For a discussion of court decisions addressing the survival of an indemnification claim after a buyer's discovery during pre-closing investigations of a possible inaccuracy in the seller's representations and warranties *see CBS, Inc. v. Ziff-Davis Publishing Co.*, 553 N.E.2d 997 (N.Y. 1990), and subsequent decisions, including *Galli v. Metz*, 973 F.2d 145 (2d Cir. 1992); *Hendricks v. Callahan*, 972 F.2d 190 (8th Cir. 1992), *Pegasus Management Co. v. Lyssa, Inc.*, 995 F. Supp. 43 (D. Mass. 1998), *Giuffrida v. American Family Brands, Inc.* Nos. Civ. A. 96-7062, Civ. A. 96-7256 1998 WL 196402 (E.D. Pa. Apr. 23, 1998). *See also Metromedia Co. v. Fugazy*, 983 F.2d 350 (2d Cir. 1992); *Rogath v. Siebenmann*, 129 F.3d 261 (2d Cir. 1997); *Coastal Power Int'l, Ltd. v. Transcon. Capital Corp.*, 10 F. Supp 2d 345 (S.D. N.Y. 1998), *aff'd*, 182 F.3d 163 (2d Cir. 1999); *Promuto v. Waste Mgmnt., Inc.*, 44 F. Supp. 2d 628 (S.D.N.Y. 1999). *See also* Robert F. Quintance, Jr., *Can You Sandbag? When a Buyer Knows Seller's Reps and Warranties are Untrue* Vol. 5 No. 9 *The M&A Lawyer* 1 (March 2002); *Merrill Lynch & Co. v. Allegheny Energy Inc.*, No. 02 Civ. 7689 (HB) 2005 WL 1663265 (S.D.N.Y. July 18, 2005), discussed in *Merrill Lynch v. Allegheny Energy: Lessons for Buyers and Sellers* by William B. Payne, Vol. 9, No. 4, *The M&A Lawyer* 18 (September

2005). *See generally Committee on Negotiated Acquisitions, Purchasing the Stock of a Privately Held Company: The Legal Effect of an Acquisition Review,*51 *THE BUSINESS LAWYER* 479 (February 1996).

(c) *Relation to Default Provisions*. Except as set forth in Section 8.3(b) (Other Remedies), the fact that a party has an indemnification right under this Article 14 will not preclude the exercise of rights under Article 8 (Dis-solution and Other Rights Upon Default).

Comment

Section 14.1(c) clarifies that the indemnification rights available to a Member under Article 14 do not limit a Member's rights under Article 8 (Dissolution and Other Rights Upon Default) to elect to dissolve the Company. However, those indemnification rights are not available to a Member that elects to purchase a 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). See the comments on Section 8.3(b) (Other Remedies).

(d) *Duty to Mitigate.* A Member must use its Best Efforts to mitigate its Damages for which it will seek indemnification or other recovery against the other Member.

Comment

Pursuant to common law and various statutory laws, a claimant for damages generally has a duty to minimize those damages. The nature and extent of this duty is dependent on circumstances giving rise to the damages in question. Subsection 14.1(d) contractually requires the Member seeking Damages to so mitigate. See also the comments to Section 14.2.

14.2 Indemnification—By Large Member. Large Member will indemnify and hold harmless and pay promptly to:

(i) the Company and

(ii) to the extent that the indemnification of, and payments to, the Company

does not constitute full payment of all Damages (as defined below) suffered by Small Member and its Affiliates and also their respective representatives and stockholders (collectively, the ‘‘Small Member Indemnified Persons’’), each Small Member Indemnified Person

the amount of any Damages (as defined below) arising from or in connection with:

(a) *Breach of Representations or Warranties*: any breach of any representation or warranty in this Agreement or in any certificate delivered pursuant to Section 3.2(b)(ii) (Accompanying Certificate) made by Large Member in connection with an Applicable Closing without giving effect to any supplement to disclosures delivered by Large Member to Small Member after execution of this Agreement and before the Applicable Closing;

(b) *Breach of Covenants*: any breach by Large Member in the performance of its covenants or obligations in this Agreement or in any certificate or document delivered pursuant to this Agreement in connection with an Applicable Closing; and

(c) *Excluded Liabilities of Large Member*: any liability, obligation, Contract or commitment (whether known or unknown and whether absolute, accrued, contingent or otherwise) (‘‘Liabilities’’) of Large Member that are not expressly assumed by the Company pursuant to this Agreement (‘‘Excluded Liabilities’’), other than Liabilities relating to Environmental Matters, for which indemnification provisions are set forth in Section 14.3 (Indemnification as to Environmental Matters—By Large Member).

‘‘Damages’’ means (A) any loss, whether in the nature of a cost, damage, expense, payment, diminution in value, liability or obligation or otherwise, and related attorneys’, accountants’ and other professional advisors’ fees and expenses (including those as to investigation, prosecution or defense of any claim or threatened claim), whether or not involving a third-party claim, and (B) only in the case of (1) Excluded Liabilities and (2) third party claims, special, incidental, consequential, punitive or any other damages.

Comment

Sections 14.2 and 14.4 define the matters for which the Large Member and the

Small Member will each have post-Closing monetary liability. Those sections are not limited to matters arising from inaccuracies in each joint venturer's representations and warranties. Rather, business conditions may dictate that other matters be the subject of indemnification. For example, Section 14.2(c) imposes indemnification obligations upon the Large Member for conditions existing before the Closing that might create successor liability for the Company (such as product liability claims arising from Large Member's pre-Closing manufacture of products that will be manufactured by the Company post-Closing). (Section 14.4(c) imposes reciprocal obligations on Small Member). Section 14.3 imposes indemnification obligations on Large Member with respect to environmental matters.

The Model JV Agreement also provides for indemnification for any inaccuracy in the certificates delivered pursuant to any Applicable Closing.

Where the joint venture agreement provides that the indemnification provisions are to be the sole remedy (as is the case with the Model JV Agreement (see Section 14.10)), it will be particularly important to ensure that all situations under which indemnification is expected are explicitly recited in the joint venture agreement.

The persons indemnified may include virtually everyone on each Member's side of the Company, including directors, officers, and stockholders who may become defendants in litigation involving the Company or who may suffer a loss resulting from their association with problems arising as a result of a prospective joint venturer's conduct before the Closing. These persons are not, however, expressly made third-party beneficiaries of the indemnification provisions, which may, therefore be read as giving the indemnified Member a contractual right to cause the indemnifying Member to indemnify such persons, and Section 17.7 provides that no third-party rights are created by the Model JV Agreement.

Creation of third-party beneficiary status may prevent the indemnified Member from amending the indemnification provisions or compromising claims for indemnification without obtaining the consent of the third-party beneficiaries.

The definition of ‘‘Damages’’ in Section 14.2 is very broad and includes, among other things, ‘‘diminution of value’’ and other losses unrelated to third-party claims. Moreover, the definition of ‘‘Damages’’ includes special, incidental, consequential, or punitive damages but only in relation to excluded liabilities and third party claims. The joint venturers may seek to narrow the definition.

The common law definition of ‘‘indemnification’’ describes a restitutionary cause of action in which a plaintiff sues a defendant for reimbursement of payments made by the plaintiff to a third party. A court may hold, therefore, that a drafter’s unadorned use of the term ‘‘indemnification’’ (usually coupled with ‘‘and hold harmless’’) refers only to compensation for losses due to third-party claims. *See Pacific Gas & Elec. Co. v. G. W. Thomas Drayage & Rigging Co*., 442 P.2d 641, 646 n.9 (Cal. 1968) (indemnity clause in a contract ambiguous on the issue; failure to admit extrinsic evidence on the point was error); *see also Mesa Sand & Gravel Co. v. Landfill, Inc.*, 759 P.2d 757, 760 (Colo. Ct. App. 1988), *rev’d in part on other grounds*, 776 P.2d 362 (Colo. 1989) (indemnification clause covers only payments made to third parties). But see *Atari Corp. v. Ernst & Whinney*, 981 F.2d 1025, 1031–32 (9th Cir. 1992) (limiting *Pacific Gas & Electric* and relying on Black’s Law Dictionary; the term ‘‘indemnification’’ is not limited to repayment of amounts expended on third-party claims); *Edward E. Gillen Co. v. United States*, 825 F.2d 1155, 1157 (7th Cir. 1987) (same). Modern usage and practice have redefined the term ‘‘indemnification’’ in the acquisition context to refer to compensation for all losses and expenses, from any source, caused by a breach of the acquisition agreement (or other specified events). The courts, presumably, will respect express contract language that incorporates the broader meaning.

Member A may argue that the appropriate measure of damages is the amount of Member B's loss, liability or expense, less any tax benefit that Member B receives as a result of the loss, liability, or expense. If this approach is accepted, the logical extension is to include in the measure of damages the tax cost to Member B of receiving the indemnification payment (including tax costs resulting from a reduction in basis). The resulting provisions, and the impact on Member B's administration of its tax affairs, are highly complex, and the entire issue of adjustment for tax benefits and costs is often omitted to avoid this complexity.

Member A may also insist that the joint venture agreement explicitly state that damages will be net of any insurance proceeds or payments from any other responsible parties. If Member B is willing to accept such a limitation, it should be careful to ensure that it is compensated for any cost it incurs due to insurance or other third-party recoveries, including those that may result from retrospective premium adjustments, experience-based premium adjustments, and indemnification obligations.

A member may insist that damages include interest from the date it first is required to pay any expense through the date the indemnification payment is received. Such a provision may be appropriate if such member expects to incur substantial expenses before its right to indemnification has been established and also lessens the other member's incentive to dispute the claim for purposes of delay.

If the joint venture agreement contains post-Closing adjustment mechanisms (as might be the case with respect to property that is being contributed to the Company, the value of which cannot be determined on or before the Closing), the joint venturers should ensure that the indemnification provisions do not require compensation for matters already rectified in the post-Closing adjustment process. This can be done by providing that the damages subject to indemnification will be reduced by the amount of any corresponding post-Closing reduction.

Suggested language for reducing the amount of Damages by any tax, insurance or

post-Closing adjustment could be stated as a proviso to the last sentence of Section 14.2:

> ‘‘; *provided, however,* that all such Damages shall be (i) reduced or increased, as the case may be, by all net Tax consequences actually realized due to the receipt of such Damages by the indemnified Member, (ii) reduced by all recoveries from any third parties, including any insurance proceeds (net of any increased costs due to a claim), actually received by the indemnified Member, and (iii) reduced by any post-Closing adjustments provided for in this Agreement.’’

Unless the agreement specifically includes ‘‘alledged’’ breaches among the indemnified matters, indemnification is not available for claims made that later prove to be groundless. Thus, a Member could incur substantial expenses in investigating and litigating a claim without being able to obtain indemnification.

14.3 Indemnification as to Environmental Matters—By Large Member. In addition to Section 14.2 (Indemnification—By Large Member), Large Member will indemnify and hold harmless and will pay promptly to:

(i) the Company and

(ii) to the extent that such indemnification of, and payments to, the Company does not constitute full payment of all Damages suffered by Small Member Indemnified Persons, each Small Member Indemnified Person

the amount of any Damages arising from or in connection with:

(a) *Environmental, Health and Safety Liabilities; Hazardous Materials*: any Environmental Health and Safety Liabilities arising out of or relating to: (i) the ownership, operation or condition of the land contributed by Large Member (the ‘‘Site’’) at any time on or before the Closing or (ii) any Hazardous Materials or other contaminants present on the Site at any time on or before the Closing; and

(b) *Bodily Injury and Property Damage*: any bodily injury, personal injury, property

damage (including trespass, nuisance, wrongful eviction and deprivation of the use of real property) or other damage of or to any Person in any way arising from any Hazardous Activity conducted with respect to the Site on or before the Closing, or from Hazardous Material that was (i) present on or before the Closing on or at the Site (or present on any other property, if that Hazardous Material emanated from the Site and was present on the Site on or before the Closing) or (ii) released on the Site any time on or before the Closing. Large Member will be entitled to control any Cleanup, any related Proceeding and any other Proceeding with respect to which indemnity may be brought under this Section; *provided*, *however*, that the procedure described in Section 14.8 (Procedure for Indemnification—Other Claims) will apply to any claim solely for monetary Damages relating to a matter covered by this Section. If Large Member exercises its right to control any Cleanup, it will (A) cause the Cleanup to be conducted in accordance with Applicable Law and industry standards, but may limit its actions to those required by the lowest cost alternative permitted by the foregoing standards after taking into account all the facts and circumstances and (B) minimize any interference with, or compensate for the loss of use, of the Company of any property on which the Cleanup or related activities occur. Large Member will promptly satisfy all requirements of Environmental Laws in relation to any property subject to a Cleanup and return the property to the condition commensurate with the value at the time the property was contributed to the Company.

Comment

Section 14.3 provides a specific monetary remedy for environmental matters because the Model JV Agreement contemplates that Large Member will be contributing real estate to the Company which, like many properties, may have conditions that potentially require environmental remediation of some degree. It is included as an example of a provision that deals specifically with contingencies that may not be adequately covered by the more general indemnification provisions and that operates independently of the

representations and warranties. The types of contingencies that may be covered in this manner will vary from joint venture to joint venture.

There are several reasons why a Member may seek to include separate indemnification for environmental matters instead of relying on the general indemnification for breaches of representations and warranties. Environmental matters are often in the nature of unknown liabilities, and Large Member may be reluctant to make representations concerning factual matters of which it cannot possibly have knowledge or cannot possibly make an accurate representation to Small Member. In addition, the nature of, and the potential for disruption arising from, environmental cleanup activities often leads joint venturers to seek different procedures for handling claims with respect to environmental matters.

It is often difficult to assess the economic adequacy of an environmental indemnity. Even with an environmental audit, estimates of the cost of remediation or compliance may prove to be considerably understated years later when the process is completed, and the Members' financial ability to meet that obligation at that time cannot be assured.

Despite some earlier authority to the effect that indemnity agreements between potentially responsible parties under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) 42 U.S.C. § 9601 *et seq*. are unenforceable (see *CPC Int'l, Inc. v. Aerojet-General Corp.*, 759 F. Supp. 1269 (W.D. Mich. 1991); *AM Int'l Inc. v. Int'l Forging Equip.*, 743 F. Supp. 525 (N.D. Ohio 1990)), it seems settled that Section 107(e)(1) of CERCLA expressly allows the contractual allocation of environmental liabilities between potentially responsible parties, and an indemnification provision would, thus, be enforceable between the Members. *See, e.g., Smith Land & Improvement Corp. v. Celotex Corp.*, 851 F.2d 86 (3d Cir. 1988), *cert. denied*, 488 U.S. 1029; *Mardan Corp. v. CGC Music, Ltd.*, 804 F.2d 1454 (9th Cir. 1986). CERCLA §

107(e)(1), however, bars a contractual allocation between parties from limiting the rights of the government or any third parties to seek redress from either of the contracting parties.

14.4 Indemnification—By Small Member. Small Member will indemnify and hold harmless and pay promptly to:

(i) the Company and

(ii) to the extent that such indemnification of, and payments to, the Company does not constitute full payment of all Damages suffered by Large Member and its Affiliates and also their respective representatives and stockholders (collectively, the ‘‘Large Member Indemnified Persons’’), each Large Member Indemnified Person

the amount of any Damages arising from or in connection with:

(a) *Breach of Representations or Warranties*: any breach of any representation or warranty in this Agreement or in any certificate delivered pursuant to Section 3.2(b)(ii) (Accompanying Certificate) made by Small Member in connection with an Applicable Closing without giving effect to any supplement to disclosures delivered by Small Member to Large Member after execution of this Agreement and before the Applicable Closing;

(b) *Breach of Covenants*: any breach by Small Member in the performance of its covenants or obligations in this Agreement or in any certificate or document delivered pursuant to this Agreement in connection with an Applicable Closing; and

(c) *Excluded Liabilities of Small Member*: any Liability of Small Member that is an Excluded Liability.

Comment

See Comments to Section 14.2.

14.5 Deduction from Indemnification Amount. Large Member will not have any liability for indemnification with respect to the matters described in Sections 14.2(a) and Small Member will not have any liability with respect to the matters described in Section

14.4(a) until the total of all Damages with respect to the matters for which the Member is otherwise liable exceeds $ _____ and then only for the amount by which the Damages exceed $ _____ This limitation will not apply to (a) any breaches of a Member's representations or warranties relating to its authority or its title to any property contributed to the Company or (b) any intentional breach by a Member of any of its representations or warranties.

Comment

Section 14.5 defines a de minimus level of Damages for which post-Closing monetary remedies are not available for breaches of representations and warranties. The purpose of the deductible is (1) to recognize that representations and warranties concerning an ongoing business are unlikely to be perfectly accurate and (2) to avoid disputes over insignificant amounts. Depending on the relative size of the joint venturers, the de minimus level of Damages might be different for each: what might seem to be a minor expense to a large enterprise may be viewed as a major burden for a small entity.

Section 14.5 provides the Member providing indemnification with a safety net, or ''deductible,'' with respect to certain categories of indemnification but does not establish a ceiling, or ''cap.'' The deductible is a minimum amount that must be exceeded before any indemnification is owed for breaches of representations and warranties. The deductible does not apply to breaches of covenants or agreements or any of the specifically indemnified matters (including the Excluded Liabilities and the environmental indemnification of Section 14.3), on the theory that each Member should be liable for its covenants and agreements made in the joint venture agreement on a ''first dollar'' basis. This provision also could be drafted to provide for a ''threshold'' deductible that, once crossed, entitles the indemnified joint venturer to recover all damages rather than merely the excess over the deductible.

This concept can also be addressed by language to the effect that a Member has no obligation ‘‘to make indemnification payments’’ unless or until the agreed upon or adjudicated (by arbitration or court) Damages exceed the specified amount.

A joint venturer entitled to indemnification can point to the deductible as a reason why the other joint venturer’s specific representations do not need materiality qualifications. In the Model JV Agreement, each Member’s representations are generally not subject to materiality qualifications, and the full dollar amount of damages caused by a breach must be indemnified, subject to the effect of the deductible established by this section. This framework avoids ‘‘double dipping’’—that is, the situation in which any indemnifying joint venturer contends that the breach exists only to the extent that it is material, and then the material breach is further subjected to the deduction of the deductible. If the joint venture agreement contains materiality qualifications to the representations, the joint venturers should consider a provision to the effect that such materiality qualifications will not be taken into account in determining the magnitude of the Damages occasioned by the breach.

With respect to covenants and agreements, an alternate approach might be to provide that the deductible applies to covenants and agreements, but only those that are to be performed or complied with at or prior to the Applicable Closing. See Comments to Section 14.6. The exclusions from the deductible might include all tax liabilities from a pre-Closing period, the damages resulting from a disclosed lawsuit and environmental liabilities. The joint venturers also may negotiate different deductibles for different types of liabilities.

The joint venturers may also seek to provide for a maximum indemnifiable amount or ‘‘cap,’’ which is frequently the value of the assets contributed by the indemnifying joint venturer to the joint venture. The joint venturer on the receiving end of the

indemnification could, of course, argue that it is not possible to calculate limitations on the business opportunity of the joint venture, and that it is therefore, not possible to accurately negotiate appropriate limitations on the indemnification liability. The joint venturers may decide to negotiate separate limits for different kinds of liabilities. Again, there is generally no limit with respect to excluded liabilities.

14.6 Time Limitations. No Member will have any liability for indemnification under this Article 14 unless the Person claiming the right to be indemnified gives notice to the Member from whom indemnification is being sought of facts that it in good faith thinks constitute a reasonable basis for indemnification:

(a) *Taxes, Products Liability and Certain Violations of Law*: in the case of claims involving Taxes, products liability, and violations of Applicable Law not covered by Section 14.6(b) below, within 30 days after the expiration of the statute of limitation (including extensions of it) applicable to Taxes, products liability and such violations, as applicable;

(b) *Environmental Matters*: in the case of claims subject to Section 14.3 (Indemnification as to Environmental Matters—By Large Member), on or before the [_____] anniversary of (i) the Closing or (ii) in the case of Additional Capital Contributions consisting of real property, of the date such contributions are made; and

(c) *Other*: in the case of claims involving any other representation or warranty or covenant to be performed and complied with at or before the Applicable Closing, on or before the [_____] anniversary of the Applicable Closing.

Notwithstanding the foregoing, no limitations as to the time for making claims applies to (i) Excluded Liabilities, (ii) those involving a Member's representations or warranties relating to its authority or its title to any property contributed to the Company, or (iii) those involving any covenant to be performed and complied with after the Applicable Closing.

Comment

It is common for an acquisition agreement to specify the time period within which a claim for indemnification must be made. The seller wants to have uncertainty eliminated after a period of time, and the buyer wants to have a reasonable opportunity to discover any basis for indemnification. The time period will vary depending upon factors such as the type of business, the adequacy of financial statements, the buyer's ability to perform a thorough investigation before the acquisition, etc. The approach to time periods within which post-Closing monetary remedies may be sought is no different in the context of a joint venture and, arguably may be longer, as the joint venturers are relying on one another to form the joint venture. On the other hand, the joint venturers may wish the security of knowing that the indemnification burden will not be around forever.

The different time periods are related to the nature of the claim. For example, indemnification for tax liabilities often extends for as long as the relevant statute of limitations for collection of the tax. If this approach is taken, the limitation should be drafted to include extensions of the statute of limitations (which are frequently granted in tax audits), situations in which there is no statute of limitations (such as those referred to in IRC § 6501(c) (including the failure to file tax returns, the filing of false tax returns, and willful attempts to evade taxes)) and a brief period after expiration of the statute of limitations to permit a claim for indemnification to be made if the tax authorities act on the last possible day. Section 14.6 contains examples of those time limitations. However, representations of good title to assets often have no limitation if they are fundamental to the transaction. Thus, Section 14.6 provides that a Member's representations and warranties relating to its title to any property contributed to the Company have no time limitation.

The Members' obligations with respect to excluded liabilities are generally not

subject to any time limitation. There also is no time limit for covenants to be performed or complied with after the Applicable Closing. This approach has been adopted, because the joint venturers typically do not want the specified time limits for bringing indemnity claims to apply to covenants to be performed post-Closing. One example of a post-Closing covenant would be an ongoing covenant in the license agreement to be executed at Closing against intellectual property infringement. In addition, the drafter of the agreement should obviously review whether or not additional post-Closing covenants are needed in the joint venture agreement itself.

14.7 Procedure for Indemnification—Third Party Claims.

(a) *Notice*. Promptly, and in any event no later than 10 Business Days after receipt by a Person entitled to indemnification of notice of the commencement of any Proceeding against it, the indemnified Person will, if a claim is to be made against an indemnifying Member, give notice to the indemnifying Member of the commencement of the claim; *provided, however*, that the failure to notify the indemnifying Member will not relieve the indemnifying Member of any liability that it may have to any indemnified Person, except to the extent that the indemnifying Member demonstrates that the defense of the Proceeding is prejudiced by the indemnified Person's failure to give the notice timely.

(b) *Participation*. If any Proceeding referred to in Section 14.7(a) is brought against an indemnified Person and the indemnified Person gives notice to the indemnifying Member of the commencement of the Proceeding, the indemnifying Member may (i) participate in the Proceeding and (ii) elect by notice to the indemnified Person to assume the defense of the Proceeding with lawyers reasonably satisfactory to the indemnified Person unless (A) the indemnifying Member is also a party to the Proceeding and the indemnified Person determines in good faith that joint representation would be inappropriate or (B) the indemnifying Member fails to provide, promptly after giving notice to the indemnified Person, reasonable assurance to the indemnified Person of its

financial capacity to defend the Proceeding and provide indemnification with respect to the Proceeding. If the indemnifying Member assumes the defense of the Proceeding, (1) the indemnifying Member will not, as long as it diligently conducts the defense, be liable to the indemnified Person under this Section for any fees of other lawyers or any other expenses with respect to the defense of the Proceeding subsequently incurred by the indemnified Person in connection with the defense of the Proceeding, other than reasonable costs of investigation and (2) no compromise or settlement of the claims may be effected by the indemnifying Member without the indemnified Person's written consent (which consent will not be unreasonably withheld or delayed) unless (x) there is no finding or admission of any violation of legal requirements or any violation of the rights of any Person and no effect on any other claims that may be made against the indemnified Person and (y) the sole relief provided is monetary damages that are paid in full by the indemnifying Member.

(c) *Right of Indemnified Person to Defend*. Notwithstanding the foregoing, if an indemnified Person determines in good faith that there is a reasonable probability that a Proceeding may adversely affect it or its Affiliates other than as a result of monetary damages for which it would be entitled to indemnification under this Agreement, the indemnified Person may, by notice to the indemnifying Member, assume the exclusive right to defend, compromise, or settle the Proceeding, but the indemnifying Member will not be bound by any determination of a Proceeding so defended or any compromise or settlement effected without its consent (which will not be unreasonably withheld or delayed).

Comment

The indemnified joint venturer normally will be required to give the indemnifying joint venturer notice of third-party claims for which indemnity is sought. The Model JV Agreement requires such notice only after a proceeding is commenced and provides that the indemnified joint venturer's failure to give notice does not affect the indemnifying joint venturer's obligations unless the

failure to give notice results in prejudice to the defense of the proceeding. In the context of a joint venture, the joint venturers may want to require notice of threatened proceedings and of claims that do not yet involve proceedings and to provide that prompt notice is a condition to indemnification, although there will be reluctance on the part of the indemnifying joint venturer to introduce the risk and uncertainty inherent in a notice requirement based upon any event other than the initiation of formal proceedings. An alternative to the proviso of Section 14.7(a) could be to provide that the burden is effectively placed on the indemnified joint venturer to establish that the indemnifying joint venturer was not prejudiced by the time lapse between the end of the notice period and the giving of the notice.

It is common to permit an indemnifying joint venturer to have some role in the defense of the claim. There is considerable room for negotiation of the manner in which that role is defined. Typically in an acquisition agreement scenario, the buyer is more likely to be the indemnified party than the indemnifying party, and so acquisition agreements often provide procedures that are favorable to the buyer, as the indemnified party.

The Model JV Agreement permits the indemnifying joint venturer to participate in and assume the defense of proceedings for which indemnification is sought but imposes significant limitations on its right to do so. The indemnifying joint venturer's right to assume the defense of proceedings is subject to (1) a conflict-of-interest test if the claim is also made against the indemnifying joint venturer, (2) a requirement that the indemnifying joint venturer demonstrate its financial capacity to conduct the defense and provide indemnification if it is unsuccessful, and (3) a requirement that the defense be conducted with lawyers reasonably satisfactory to the indemnified joint venturer. The response to the language is often to resist the financial capacity requirement (particularly in the case of Small Member) and seek to modify the

requirement that lawyers be satisfactory by identifying satisfactory lawyers in the joint venture agreement (a Member's lawyers should carefully consider in whose interest they are acting if they specify themselves). The Members may also agree to a provision that, in cases in which the indemnifying Member does not assume the defense, all indemnified parties be represented by the same lawyers (subject to conflict of interest concerns).

Often in an acquisition agreement, there is a provision that the indemnifying party is bound by the indemnified party's defense or settlement of a proceeding if the indemnifying party does not assume the defense of that proceeding within a specified number of days after notice of the proceeding. In addition, an indemnifying party may request a right to assume the defense of the proceeding at a later date and a requirement for advance notice of a proposed settlement. The Model JV Agreement focuses on provisions designed to keep the joint venture together and therefore, does not contain a provision commonly found in acquisition agreements that the indemnifying joint venturer is bound by the indemnified joint venturer's defense if it does not assume the defense within specified number of days after receiving notice of the proceeding. An indemnified Member usually will be reluctant to permit an indemnifying joint venturer to assume the defense of a proceeding while reserving the right to argue that the claims made in that proceeding are not subject to indemnification. The indemnifying joint venturer may object, however, that the nature of the claims could be unclear at the start of a proceeding and may seek the right to reserve its rights in a manner similar to that often permitted to liability insurers. The Model JV Agreement does not preclude that possibility. However, if the joint venturers do wish to take that position, language will need to be included to the effect that the assumption of the defense by the indemnifying joint venturer would conclusively establish that the claim is within the scope of indemnification.

An indemnifying joint venturer that has assumed the defense of a proceeding will

seek the broadest possible right to settle the matter.

The Model JV Agreement imposes strict limits on that right; the conditions relating to the effect on other claims and the admission of violations of legal requirements are often the subject of negotiation.

Section 14.7(c) permits the indemnified Member to retain control of a proceeding that presents a significant risk of injury beyond monetary damages that would be borne by the indemnifying joint venturer, but the price of that retained control is that the indemnifying joint venturer will not be bound by determinations made in that proceeding. A Member may want to maintain control of a proceeding seeking equitable relief that could have an impact on its business that would be difficult to measure as a monetary loss or of a proceeding involving product liability claims that extend beyond the Member's businesses.

14.8 Procedure for Indemnification—Other Claims. A claim for indemnification for any matter not involving a third-party claim will be asserted by notice to the Member from whom indemnification is sought promptly after becoming aware of the acts or omissions or facts and circumstances on which the claim is based, but the failure to notify the indemnifying Member will not relieve the indemnifying Member of any liability that it may have to any indemnified Person, except to the extent that the indemnifying Member demonstrates that it is prejudiced by the failure. That notice is notice of a Legal Claim for purposes of Section 13.2(a) (Dispute Resolution Procedures—Negotiation).

Comment

Note that a claim for indemnification under Section 14.8 satisfies the notice requirements under the dispute resolution procedures of Article 13.

14.9 Satisfaction of Indemnification Obligations.

Subject to the procedures set forth above and in accordance with the deadlines specified in the preceding subsections, indemnified Damages will be satisfied as follows:

(a) *To the Company*. An indemnifying Member will satisfy its liability to the

Company for indemnified Damages by paying the amount of the liability to the Company.

(b) *To a Small Member Indemnified Person or to a Large Member Indemnified Person*. An indemnifying Member will satisfy its liability to a Small Member Indemnified Person or to a Large Member Indemnified Person (as applicable) for indemnified Damages by paying the amount of the liability to the Person.

Payments pursuant to the foregoing will be by wire transfer or by check, as the recipient may direct. In the absence of directions within a reasonable period of time, payment may be made by check.

Comment

Section 14.9 sets out how the awards under the various indemnification provisions are to be settled as between the Company and the indemnified persons.

The Model JV Agreement does not specifically provide that amounts owing to the indemnified person may be set off against amounts owing to the indemnifying Member at the election of the indemnified person. Even without an express right of setoff in the joint venture agreement or related documents, one Member can, as a practical matter, withhold amounts from payments due to the other Member under the joint venture agreement or the related documents on the ground that the withholding Member is entitled to indemnification for those amounts under the joint venture agreement. The question then is whether, if the other Member proceeds against the withholding Member for its failure to make full payment, the withholding Member will be able to counter-claim that it is entitled to setoff the amounts for which it believes it is entitled to indemnification.

The common law of counterclaim and setoff varies from state to state, and when

deciding whether to include or forego an express right of setoff in the joint venture agreement, lawyers should examine the law governing the joint venture agreement and determine if applicable law contains requirements such as a common transaction, mutuality of parties, and a liquidated amount and, if so, whether those requirements would be met in the context of a dispute under the joint venture agreement and related documents. Generally, counterclaim is mandatory when both the payment due to the plaintiff and the amount set off by the defendant relate to the same transaction, see *United States v. Southern California Edison Co.*, 229 F. Supp. 268, 270 (S.D. Cal. 1964); when different transactions are involved, the court may, in its discretion, permit a counterclaim, see *Rochester Genesee Regional Transp. Dist., Inc. v. Trans World Airlines, Inc.*, 383 N.Y.S.2d 856, 857 (1976), but is not obligated to do so, see *Columbia Gas Transmission Corp. v. Larry H. Wright, Inc.*, 443 F. Supp. 14 (S.D. Ohio 1977); *Townsend v. Bentley*, 292 S.E.2d 19 (N.C. Ct. App. 1982).

Also, a counterclaim might not be possible if the parties obligated to make and entitled to receive the various payments are different (that is, if there is not ‘‘mutuality of parties’’).

The drafters of the Model JV Agreement have not included language addressing strict liability or indemnitee negligence. For the discussion of those topics see the commentary to the *Model Asset Purchase Agreement with Commentary*.

14.10 Exclusiveness of Remedies. Except (a) as provided in Section 8.3(b) (Other Remedies) and 14.1(c) (Relation to Default Provisions) and (b) for acts or omissions intended to mislead the Person seeking indemnification and (c) subject to the procedures set forth in Article 13 (Dispute Resolution), the remedies provided in this Article constitute the sole and exclusive remedies available to the Company, the Small Member Indemnified Persons and the Large Member Indemnified Persons with respect to matters covered in Sections 14.2 through 14.4. Neither the foregoing nor anything else in this

Agreement will limit the right of a Member or the Company to enforce the performance of this Agreement or of any Contract, document or other instrument executed and delivered pursuant to this Agreement by any remedy available to it in equity, including specific performance. The Members waive any requirement that the Person seeking equitable relief post a bond or other security.

Comment

In the absence of explicit provision to the contrary, a joint venturer's remedies for inaccuracies or breaches in the other member's representations and covenants may not be limited to those provided by the indemnification provisions. The joint venturer may also have causes of action based upon breach of contract, fraud and misrepresentation and other federal and state statutory claims until the expiration of the applicable statute of limitations. The joint venturers, therefore, may want to add a clause providing that the indemnification provisions are the sole remedy for any claims relating to breaches of a joint venturer's representations and warranties. This provision could also limit the parties' rights to monetary damages only, at least after Closing. Section 14.10 provides that, except with respect to certain provisions, and subject to following certain procedures, the remedies provided in Article 14 are the sole and exclusive remedies available with respect to such inaccuracies and breaches. See also the comment to Section

2.4—''The Effect of 'Non-Reliance' Clauses.''

Article 15: Competition

General Comment

The restrictions in Article 15 are designed to prevent each Member from competing with the Company during the period each Member has an ownership interest in the Company and for a certain period following the date the Members cease to be members (either as a result of a buy-out of one of the Members or a

dissolution of the Company) if the Business of the Company is continued following the buy-out or dissolution.

These restrictions include prohibitions on competing with the Business of the Company (Section 15.1(b)(i)), on soliciting Company customers (Section 15.1(b)(ii)), on soliciting Company employees (Section 15.1(b)(iii)), and on using the trade name or trademark used by the Company (Section 15.1(b)(iv)).

The drafter also will need to review applicable state laws governing restrictive covenants to determine whether the provisions of this Article 15 are in compliance with those laws.

For a general discussion of antitrust principles and the applicability of the Hart-Scott Rodino Act, see the discussions in the Preliminary Considerations.

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.

(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[SM] 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.

Comment

The enforceability of restrictive covenants is a matter of state law and the drafter

will need to review applicable state law to determine whether the covenants in this Article 15 are enforceable. Although those covenants typically are viewed as agreements in restraint of trade, they generally are enforceable under most state laws as long as they are reasonable in relation to time, territory and the scope of the restricted activity. (For a general discussion of non-compete covenants, see the commentary to the Noncom-petition Agreement included as an exhibit to the *Model Stock Purchase Agreement with Commentary* and the Noncompetition, Nondisclosure and Nonsolicitation Agreement included as an exhibit to the *Model Asset Purchase Agreement with Commentary*.) As a general rule, covenants against competition that are entered into in connection with the sale of a business are more likely to be enforceable than similar covenants that are entered into with employees. Of particular focus to many courts is the relative bargaining power of the joint venturers—courts viewing the seller and the buyer in the sale of a business transaction as usually being of fairly equal bargaining power, as opposed to the bargaining power an employee typically has vis-à-vis his or her employer. Because the covenants in Article 15 do not clearly fit within either a sale of business or an employment context, a state court construing such covenants most likely will focus on the relative bargaining power of Large Member and Small Member.

In their current form, the provisions of Section 15.1 generally are reasonable restraints on the business activities of Large Member and Small Member under federal antitrust law. Although both joint venturers are excluded from the Business, this is unlikely to be anticompetitive under the assumed Fact Pattern. The Fact Pattern assumes: (1) that the Company will create a second-generation product far more easily than either Member could do on its own, (2) that the Company will achieve efficiencies even as to the current generation product, and (3) that the Members collectively do not have more than a 15% share of the relevant market. A non-compete of the specified

duration and scope may well be required to protect the Members and the Company from either Member using confidential information from the joint venture or otherwise competing in ways that undermine the joint venture and cause the other Member to be unwilling to invest the resources or contribute knowledge necessary for the joint venture to succeed.

CAVEAT: It would be prudent, however, for an experienced antitrust lawyer to ascertain from the business people the facts that make the restriction, as well as its duration and scope, reasonably necessary.

Section 15.1(d) restricts the use of the trade name and trademark of the Company by the Members and their Affiliates. This restriction will be of particular importance upon the departure of one of the Members, or the dissolution of the Company, when one of the Members or a third party purchaser continues the Company's Business. For a discussion of the care that needs to be taken in the protection of trademarks, trade names and other intellectual property of a joint venture in drafting a joint venture agreement, see *Top Ten Things Not to Do When Structuring a Joint Venture Agreement* by John Palenberg, 2 No. 4 *The M&A Lawyer* 1 (July-August 1998).

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.

Comment

Section 15.2 deals with how the Company gains access to existing distribution

networks. First, the Members preserve their distribution network for non-competing products by agreeing that continued distribution will not constitute a breach of the joint venture agreement. Second, this section enables the Company to access the Members' distribution networks for distribution of Products by requiring each Member to waive any claim it may have against its distributors for distributing Products for the Company.

However, Section 15.2 does not address potential competition concerns with respect to those distributors that are excluded from the Products network. For example, suppose the joint venture decides to use Small Member's exclusive distributor in a certain geographic area, and decides not to use Large Member's exclusive distributor for that same area. Large Member's distributor may argue that, since the joint venture is under the control of Large Member, its distribution agreement with Large Member entitles it to distribute Products. Large Member could be exposing itself to a breach of contract action, and Small Member and the joint venture could be exposing themselves to claims of tortuous interference.

To prevent that situation from arising, each Member should conduct due diligence and ensure that the other Member provides copies of all of its relevant distribution agreements. Each distribution agreement should be reviewed to determine whether it should be renegotiated or terminated to prevent future claims by distributors. The following additional provisions should be considered in order to ensure that the relevant Member renegotiates or terminates its distribution agreements before closing, where necessary.

- The Members could add a pre-closing covenant under which the Members undertake to re-negotiate or terminate certain distribution agreements with their respective distributors before Closing.
- The Members could add a closing condition that requires each Member to re-

negotiate or terminate certain distribution agreements with their respective distributors before Closing.

- The Members could agree to indemnify the joint venture and one another for any claim brought by their respective distributors after Closing in connection with the joint venture's decision not to use those distributors in its products distribution network.

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.

Comment

Section 15.3 is in addition to severability provisions applicable to the entire Model JV Agreement in § 17.8, and thus while this section may not be necessary as duplicative, many drafters include a separate severability provision clearly applicable to those restricting competition.

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.

Comment

Section 15.4 is a fairly typical provision that is designed to permit ‘‘blue penciling’’ of the restrictions in Article 15 if permitted by applicable law.

Article 16: Confidentiality

General Comment

The confidentiality provisions of Article 16 protect Confidential Information and Trade Secrets of the Company itself. By contrast, the confidentiality provisions of the Pre-Joint Venture Formation Confidentiality Agreement are designed to protect confidential information and trade secrets each Member discloses to the other in connection with the formation of the Company. Section 16.12 provides that the Pre-Joint Venture Formation Confidentiality Agreement continues in effect following the formation of the joint venture with respect to information of either Member that does not become either confidential information of the joint venture or information subject to the Technology License Agreement.

As with the Pre-Joint Venture Formation Confidentiality Agreement provisions, this commentary addresses only those aspects unique to a joint venture agreement. For a discussion of confidentiality agreements in general, the drafter should consult the commentary to Article 12 of the *Model Asset Purchase Agreement with Commentary*, the Model Confidentiality Agreement included as an exhibit to the *Model Asset Purchase Agreement with Commentary* and as an exhibit to the *Model Stock Purchase Agreement with Commentary*.

16.1 Confidentiality—This Agreement. Except as otherwise expressly permitted by this Article 16, each Member and the Company will keep confidential, will not disclose and will otherwise retain in strictest confidence the terms of this Agreement; *provided, however*, either Member or the Company may make announcements or give notices concerning this Agreement to the employees of the Company or of a Member, or to the customers or suppliers of the Company or a Member, if that announcement or notice is

either (a) approved by both Members or (b) expressly permitted by this Article 16.

Comment

Section 16.1 is designed to maintain the confidentiality of the terms of the joint venture agreement. This may be of particular importance if the Members desire to prevent the terms of the joint venture agreement from being disclosed to competitors, distributors, suppliers or customers of one or both of the Members or of the joint venture. This does not prohibit the disclosure of the fact that they have entered into the joint venture agreement, and in certain circumstances, that may be desired. However, recognizing that the Members and the joint venture may be required, in the course of operating their businesses, to make announcements or disclose certain terms of the joint venture agreement (for example, the identity of the Members), Section 16.1 permits an announcement if it is approved by both Members or is otherwise permitted by Article 16. For example, either or both of the Members may be required to disclose the terms of the joint venture agreement pursuant to applicable securities laws (see Section 16.4(f)).

16.2 Confidentiality—Company Information. Except as otherwise expressly permitted by this Article 16:

(a) *Obligations of the Members.* Each Member will keep confidential, will not disclose, will not use, and will otherwise retain in strictest confidence the Company Information. Without limiting the foregoing, each Member will use no less than the same degree of care, and no less than a reasonable degree of care, to protect the Company Information as it uses to protect its own trade secrets and confidential information.

(b) *Obligations of the Company.* The Company will keep confidential, will not disclose, and will otherwise retain in strictest confidence the Company Information. The foregoing permits the Company to use the Company Information, but the Company will adopt procedures in connection with its use of Company Information that are reasonably expected to prevent that information from becoming publicly available. The foregoing does

not limit the Company's obligations otherwise set forth in this Article 16, including those in Section 16.5 (Permitted Disclosures to Representatives) and Section 16.6 (Disclosure to Non-Representatives).

Comment

In addition to imposing a duty of confidentiality on each Member as to Company Information, this Section also imposes that duty on the Company itself. This recognizes that the Company's Confidential Information and Trade Secrets are of value to each Member. Accordingly, while acknowledging that the Company will need to use its Company Information in operating its business, this Section requires the Company to adopt reasonable procedures to prevent the Company Information from becoming publicly available. Those steps will likely depend on the governance of the joint venture and the involvement of the Members in the joint venture. The Model JV Agreement provides that the Company's activities will be managed by a four-member Management Committee, on which Large Member and Small Member will have equal representation, but with the Chair (a Large Member appointee) having an additional vote to break ties. The Fact Pattern assumes that, although the Company will at least initially be subject to substantial oversight through the Management Committee, eventually the Company will become substantially independent, perhaps with independent managers. Accordingly, the Model JV Agreement requires the Company to comply with certain procedures in disclosing Company Information to its Representatives and third parties. Section 16.5 addresses the requirements for disclosing Company Information to Representatives, and Section 16.6 sets forth the requirements for disclosing Company Information to non-Representatives. However, at the time the Company becomes more independent (or if it initially operates on an independent basis), the requirements of Sections 16.5 and 16.6 may be unduly

burdensome. For example, if the Company needs to disclose management information that is ordinarily regarded as confidential, Section 16.5 would require a Company Representative who receives that disclosure to be advised in writing of the confidential nature of the information each time that information is disclosed— a practice that may not typically be followed by a large corporation when disclosing confidential information to its employees who work on a particular project. Similarly, Section 16.6 would require any non-Representative recipient of the disclosure to execute a confidentiality agreement in a form approved by the Management Committee. That requirement also may be unreasonably burdensome once the Company becomes more independent, and its disclosure of Company Information should be left to its own discretion.

16.3 Definitions—Company Information and Other.

Comment

Sections 16.3 through 16.8 are very similar to the corresponding provisions in the Pre-Joint Venture Formation Confidentiality Agreement, except that these Sections apply to Company information rather than that of each Member.

(a) *Company Information*. ‘‘Company Information’’ means all information (whether written, oral or in another form) that consists of, or includes, the Company’s Trade Secrets or Confidential Information.

(b) *Trade Secrets.* ‘‘Trade Secrets’’ means trade secrets under applicable trade secret or other law; and includes, however documented, concepts, ideas, designs, know-how, methods, data, processes, formulae, compositions, improvements, inventions, discoveries, product specifications, past, current and planned research and development and manufacturing or distribution methods and processes, lists of actual or potential customers or suppliers, current and anticipated customer requirements, price lists, market studies, business plans, computer software and programs (including object code and source code), computer software and database technologies, systems, structures and architectures, and

any other information that is a trade secret within the meaning of _____§ _____-_____-_____ [applicable state trade secret law]).

(c) *Confidential Information*. ‘‘Confidential Information’’ means written or other information concerning the Company, other than trade secrets, not generally known to the public; and, to the extent consistent with the foregoing definition, includes historical financial statements, financial projections and budgets, historical and projected sales, capital spending budgets and plans, _____, and any information that is marked ‘‘confidential’’ or in some comparable manner.

16.4 Certain Exceptions. The prohibitions in Sections 16.1 and 16.2 will not apply only to the extent that:

(a) *Previously in Possession.* The disclosing Person (i) demonstrates through written records that the same Company Information was in its possession before disclosure to it and (ii) the disclosing Person provided the Company and each Member with written notice of prior possession either (A) before the execution and delivery of this Agreement or (B) if the disclosing Person later becomes aware of (through disclosure by the Company or otherwise) some aspect of the Company Information as to which it had prior possession, promptly upon its becoming aware of the Company Information;

(b) *Becomes Public.* The disclosing Person demonstrates (i) that the same information is currently publicly available or has become publicly available and (ii) that such public availability does not result from (A) the misappropriation or improper disclosure of such Company Information by the disclosing Person or (B) the obtaining of such Company Information by improper means of the disclosing Person;

(c) *Independently Developed.* The disclosing Person demonstrates that the same information was developed independently by the disclosing Person without the use of the Company Information;

(d) *Legal Obligation to Disclose.* The disclosing Person demonstrates that Applicable Law requires it to disclose the Company Information, but then only (i) to the extent

disclosure is required and (ii) after giving the Company and each Member notice of the obligation so that it may seek a protective order or other similar or appropriate relief. In the absence of an order or relief, the disclosing Person must use reasonable efforts to have the disclosed information treated confidentially consistent with this Article;

(e) *Enforcement of Agreement*. The disclosing Person demonstrates that it is reasonably necessary for the disclosing Person to make the disclosure to enforce this Agreement, and then only if the disclosing Person undertakes in good faith to limit the manner and extent of that disclosure to the extent practical including obtaining protective orders from the court or arbitrator from whom enforcement is sought;

(f) *Stock Exchange Rules and Securities Laws.* The disclosing Person demonstrates that disclosure is, in the written opinion of lawyers to the disclosing Person, necessary or desirable in order to comply with applicable stock exchange rules or federal or state securities laws; or

(g) *Sale of Member Interest.* Disclosure is made by a Member or the Company in connection with the sale, transfer or other disposition, in whole or in part, of a Member Interest or the assets of the Company in accordance with this Agreement (but then only if disclosure is subject to a non-disclosure agreement then customary in such transactions and as to which the Company, the other Member and each of its Affiliates is a third party beneficiary).

Comment

Because a prospective purchaser of a Member's interest or of the assets of the Company will require detailed information about the Company before agreeing to such purchase, Section 16.4(g) permits disclosures that may be necessary or appropriate in the context of a sale of a Member Interest under Article 10 or Article 11 or the sale of the Company assets upon dissolution and liquidation of the Company under Article 9.

16.5 Permitted Disclosure to Representatives. Notwithstanding the prohibitions of

this Article, each Member and the Company may disclose the terms of this Agreement and Company Information to its Representatives directly involved with the Company but:

(a) only to the extent necessary for the Representative to accomplish his assigned tasks and otherwise strictly on a need to know basis; and

(b) only if the Representative (i) is provided a copy of this Article and (ii) is advised in writing by the disclosing Person (A) that he is obligated to keep confidential, not disclose and retain in strictest confidence the terms of this Agreement and the Company Information strictly in accordance with terms of this Article and (B) that the Company or any Member may directly enforce the obligation.

A Person disclosing Confidential Information to a Representative pursuant to this Section will promptly notify the other Member and the Company of the name and title of that Representative and certify that it has advised the Representative of the obligations. Each disclosing Person will be responsible for violations of this Article by its Representatives regardless of whether the Company or any Member has rights against the Representative.

‘‘Representatives’’ means a Person’s directors, officers, employees, agents, consultants, advisors or other representatives, including lawyers, accountants and financial advisors. In the case of a Member, ‘‘Representatives’’ includes the Representatives of that Member’s Affiliates.

Comment

As noted in the Comment under Section 16.2, the procedures required by this Section 16.5 may be unduly burdensome as the Company becomes more independent (or if the Company initially operates on an independent basis). Once the Company has its own employees (as opposed to relying on employees of the Members), an alternative approach is for the Company to enter into secrecy agreements with each of its employees as a condition of employment with the Company.

16.6 Disclosure to Non-Representatives. Any disclosure of the terms of this Agreement or any Company Information may be made to a non-Representative only if the receiving Person executes and delivers a confidentiality agreement in form and substance approved by the Management Committee.

16.7 Continuing Protection of Trade Secrets. Any Trade Secrets of the Company will also be entitled to all of the protections and benefits under Applicable Law. If a court of competent jurisdiction determines that any Company Information that the Company deems to be a Trade Secret is not a Trade Secret, or ceases to be a Trade Secret under Applicable Law, then the Company Information will be considered Confidential Information for purposes of this Article.

16.8 Remedies. Each Member recognizes that the activities proscribed by this Article will result in irreparable damage and harm to the Company and the Members and that the Company and Members and their Affiliates may be without an adequate remedy at law in the event of any such activities. Therefore, if any of the foregoing Sections of this Article is breached or is threatened to be breached, the Company, each Member, and each of their Affiliates may: (a) obtain specific performance; (b) enjoin any Person that has breached or threatens to breach from engaging in any activity proscribed by this Article; and (c) pursue any one or more of the foregoing or any other remedy available to it under Applicable Law, including actual and/or punitive damages and set-off rights. A Person seeking or obtaining any such relief will not be deemed to be precluded from obtaining any other relief to which that Person may be entitled. Each Member waives on behalf of itself and each of its Affiliates any requirement that a Person seeking to enforce this Article submit proof of the economic value of any Trade Secret or post any bond or other security in connection therewith.

Comment

In most cases, the remedy that will be sought for breach of the confidentiality provisions of this Article 16 will be injunctive relief to prevent or halt the

prohibited activity. However, if a person has been harmed by the prohibited activity, damages also may be appropriate. If one of the Members is the breaching party, the issue of which person is liable for the payment of damages is clear (it's the breaching Member, regardless of whether the damaged person is the other Member or the Company). However, if the breaching person is the Company, the issue needs to be addressed as to how such damages are paid. For example, if they are paid by the Company, the result is that the damaged Member receives the payment, but suffers a ''loss'' since the funds used by the Company to pay the damages are not otherwise available for distribution to the Member or for Company uses. The Model JV Agreement is silent on this issue.

16.9 Attorney-Client Privilege. To the extent that any Company Information includes materials subject to the attorney-client privilege, the Company is not waiving and will not be deemed to have waived or diminished its attorney work-product protections, attorney-client privileges or similar protections and privileges as a result of disclosing any Company Information (including Company Information related to pending or threatened litigation) to a Member, whether or not the Company has asserted, or is or may be entitled to assert, those privileges and protections. The Company and the Members: (a) share a common legal and commercial interest in all such Company Information that is subject to such privileges and protections; (b) are or may become joint defendants in proceedings to which such Company Information covered by those protections and privileges relates; and (c) intend that those privileges and protections remain intact if the Company or any Member becomes subject to any actual or threatened proceeding to which such Company Information covered by such protections and privileges relates. In furtherance of the foregoing, no Member shall claim or contend, in proceedings involving the Company or any Member, that the Company waived its attorney work-product protections, attorney-client privileges or similar protections and privileges as a result of disclosing any Company Information (including Company Information related to pending or threatened litigation) to

the Member.

Comment

There may be instances where the Company will need to disclose litigation-related Company Information to its Members. Section

16.9 is an attempt to allow the Company to furnish to its Members Company Information without waiving the Company's work product, attorney-client privilege and similar protections by demonstrating that each Member and the Company have, or should be presumed to have, common legal and commercial interests, or are or may become joint defendants in litigation. The language in Section 16.9 is not yet reflected in statutory or case law, may be disregarded by a court, and may even ''flag'' the issue of privilege waiver for adverse parties who obtain the joint venture agreement. For a general discussion of attorney-client privilege in confidentiality agreements, see the commentary to Article 12 of the *Model Asset Purchase Agreement with Commentary*.

16.10 Continuing Obligations. The obligations in this Article will be effective from the date of this Agreement and will bind (a) the Company indefinitely and (b) each Member (i) with respect to the Company's Confidential Information, for so long as that Member is bound by the non-competition provisions of Article 15 (Competition) and (ii) with respect to the Company's Trade Secrets, for as long as the Company's Trade Secrets remain trade secrets under Applicable Law.

Comment

The confidentiality obligations of Article 16 bind the Company indefinitely and bind each Member for as long as it is a Member and until the 60th month following a Buy-Out Event or the Dissolution Date. The duration of these restrictions matches the period that a Member is bound by the non-competition provisions of Article 15.

16.11 No Limitation on Other Agreements. The prohibitions in this Article are in addition to, and will be interpreted as separate and independent from, any similar

prohibitions in:

(a) the Technology License Agreement; and

(b) any agreement between the Company and any of its Representatives that limits the use or disclosure of information concerning the Company.

Comment

Based on the significance and value of the technology being licensed from Small Member and Large Member to the Company, Section 16.10(a) provides that the provisions of this Article are in addition to any similar prohibitions contained in the Technology License Agreement.

Section 16.10(b) provides that the terms of any confidentiality agreement between the Company and its Representatives will be in addition to the confidentiality limitations of this Article 16. Although the Company is not a party to the Model JV Agreement, Section 2.11 provides that the Members will cause the Company to fulfill its obligations under the Model JV Agreement and provides a mechanism for a Member to bring an action on the Company's behalf against the other Member. Section 16.8 grants to each Member and the Company the right to obtain injunctive relief for a breach of the confidentiality provisions of this Article.

16.12 Pre-Joint Venture Confidentiality Agreement. The rights and obligations of the Members under the Pre-Joint Venture Confidentiality Agreement dated _____, 200 ___will continue in full force and effect with respect to information of either Member that is not, and does not become, either (a) Company Information pursuant to this Article or (b) information subject to the Technology License Agreement.

Comment

Because Article 16 applies only to Company Information and not to any Confidential Information or Trade Secrets of the Members, Section 16.11 provides that the limitations under the Pre-Joint Venture Formation

Confidentiality Agreement will continue with respect to information that is not, or does not become, either Company Information or information that is subject to the Technology License Agreement.

Article 17: Miscellaneous

General Comment

Few of these provisions are unique to a joint venture agreement, and more extensive discussion can be found in the ABA *Model Stock Purchase Agreement with Commentary* and *Model Asset Purchase Agreement with Commentary*.

17.1 Further Assurances.

(a) *Generally.* The Members will (i) furnish upon request to each other further information, (ii) execute and deliver to each other documents, and (iii) do other acts and things, all as the other Member may reasonably request for the purpose of carrying out the intent of this Agreement and the documents referred to in this Agreement.

(b) *Transition.* In connection with and for a reasonable time following a purchase of a Member's Member Interest, the selling Member will cooperate in connection with any reasonable requests of the Company or the other Member to effect the purchase, but the selling Member will be entitled to be reimbursed the actual out-of-pocket expenses it incurs in complying with the request.

Comment

The requirement for further assurances contemplates two separate periods of time. The first is the period before the Closing and during the operation of the joint venture. The second period covers a transition following purchase of a Member Interest.

This section reflects the obligation, implicit in other areas of the Model JV Agreement, for the joint venturers to cooperate to fulfill their respective obligations under the Model JV Agreement and to satisfy the conditions precedent to their respective obligations. This section would be invoked if one prospective joint

venturer were, for example, to intentionally fail to undertake actions necessary to fulfill its own conditions to closing and use the failure of those conditions as a pretext for refusing to close.

A ‘‘further assurances’’ provision is common in transaction agreements. The further assurances provision assures each joint venturer that routine matters will be accomplished and that the other joint venturer will not withhold signatures required for transferring assets or consenting to transfers of business licenses and similar acts in an attempt to extract additional consideration.

In addition to the covenants in Section 17.1, a joint venture agreement may contain covenants that involve matters that cannot be conditions precedent to the Closing because of time or other considerations but that the joint venturers view as an important part of the transaction. These additional covenants may arise out of exceptions to the joint venturers’ representations and warranties contained in the attachments. For example, one person may covenant to remove a title encumbrance, finalize a legal proceeding or resolve an environmental problem. Ordinarily there is a value placed on each post-closing covenant so that if the person obligated by the covenant does not perform, the other person is compensated in some manner.

17.2 Notices. Ordinary course business communications in connection with the performance of this Agreement may be given electronically, by fax, by mail or any other comparable means, but any such communication will be deemed received only upon actual receipt. Any other notice, communication and delivery under this Agreement (including one of default or termination): (a) will be made in writing signed by the Person making it; (b) will specify the Section to which it relates; (c) will be delivered only (i) in person, (ii) by nationally recognized next Business Day delivery service electing, and being timely delivered to such service for, next Business Day delivery, or (iii) by fax and with a confirming copy sent by a nationally recognized next Business Day delivery service electing, and being timely delivered to such service for, next Business Day delivery; (d)

unless given in person, will be given to the address specified below; (e) will be deemed given (i) if delivered in person, on the date of personal delivery, (ii) if sent by nationally recognized next Business Day delivery service electing, and being timely delivered to such service for, next Business Day delivery, on the first Business Day after so sent, or (iii) if sent by fax with a copy sent by a nationally recognized Business Day delivery service electing, and being timely delivered to such service for, next Business Day delivery, on the first Business Day after so sent; and (f) will be deemed received (i) if delivered in person, on the date of personal delivery, (ii) if sent by nationally recognized next Business Day delivery service electing, and being timely delivered to such service for, next Business Day delivery, on the first Business Day after so sent, and (iii) if sent by fax and with a confirming copy sent by a nationally recognized next Business Day delivery service electing, and being timely delivered to such service for, next Business Day delivery, on the first Business Day after so sent. The Person giving the notice will pay all delivery costs. The addresses and the requirements for copies are as follows:

If to Large Member, to:	with a copy to:
_____	_____
_____, _____ ,	_____, _____
Attention: _____	Attention: _____
Fax No.: _____	Fax No.: _____
If to Small Member, to:	with a copy to:
_____	_____
Attention: _____	Attention: _____
Fax No.: _____	Fax No.: _____

Notice will be given to such other representatives or at such other addresses as a Person may furnish to the other Persons entitled to notice pursuant to the foregoing. If notice is given pursuant to this Section of a permitted successor or assign of a Person, then notice will thereafter be given as set forth above also to such successor or assign of such Person.

Comment

There are many varieties of notice provisions in transactional documents. The Model JV Agreement provides three alternative means for giving notice and sending other communications: (i) delivery in person, (ii) delivery by next business day courier, and (iii) delivery by fax with a confirming copy sent by overnight courier. This notice provision does not permit notices by e-mail, on the theory that it is too easy for an e-mail to be overlooked or inadvertantly deleted in the tremendous volume of e-mails that the recipient is likely to receive.

Another concern about notice provisions is the deemed delivery date, which is sometimes set as the time when the notice is actually received. The Model JV Agreement provides rules as to when the delivery will be deemed received that mirror the way the notice is actually given.

With regard to the use of facsimile, there is a concern that this technology is unreliable and is susceptible to interception by other persons. This concern about reliability can be alleviated to some extent by requiring confirmation of transmission by the transmitting equipment or confirmation by telephone of receipt of a facsimile transmission. Most facsimile equipment will print a transmission report that confirms successful transmission and identifies the facsimile number and, in some cases, the person to which the notice has been sent. When notice is permitted to be given by facsimile, a requirement is sometimes added (as here) that a copy of the notice also be sent by overnight courier.

17.3 Jurisdiction; Service of Process. All actions or Proceedings relating to this Agreement (whether to enforce a right or obligation or obtain a remedy or otherwise) that are not subject to Article 13 (Dispute Resolution) will be brought solely in the state or federal courts located in or for _____ County, _____. Each Member hereby unconditionally and irrevocably consents to the jurisdiction of those courts and waives its rights to bring any action or Proceeding against the other Member except in those courts.

Process in any action or Proceeding referred to in the preceding sentence may be served on any Member anywhere in the world. Each Member irrevocably waives any right to a jury trial with respect to any matter arising out of or in connection with this Agreement. If any Member seeks to enforce its rights under this Agreement by joining another Person to a Proceeding before a jury in which the third party is a party, the parties will request the court to try the claims between the Members without submitting the matter to the jury.

Comment

Section 17.3 provides that service of process may be obtained on any joint venturer anywhere in the world and is intended to waive the requirement of acquiring in personam jurisdiction. In this section, the joint venturers select an exclusive forum for actions arising out of or relating to the Model JV Agreement and submit to jurisdiction in that forum. The forum selected by Large Member usually will be its principal place of business, which may not be acceptable to Small Member. Small Member may attempt to change the designation to a more convenient forum or simply to confer jurisdiction in the forum selected by the Large Member without making it the exclusive forum. For an analysis of whether a forum selection clause is permissive or exclusive, see *Action Corp v. Toshiba Am. Consumer Prods., Inc.*, 975 F. Supp. 170 (D.P.R. 1997).

Clauses by which the parties consent to jurisdiction are usually given effect so long as they have been freely negotiated among sophisticated parties (*but see* DLLCA § 18–109(d) (‘‘a member who is not a manager may not waive its right to maintain a legal action or proceeding in the courts of the State of Delaware with respect to matters relating to the organization or internal affairs of a limited liability company’’)). Exclusive forum selection clauses are generally upheld by the courts if they have been freely bargained for, are not contrary to an important public policy of the forum and are generally reasonable. *See generally* Robert C. Casad, *Jurisdiction and Forum Selection* § 4,17 (1988 & Supp. 1999). Accordingly, a court in the forum other than

the one selected may, in certain circumstances, elect to assert jurisdiction, notwithstanding the parties' designation of another forum. In these situations, the courts will determine whether the provision in the agreement violates public policy of that state and, therefore, makes enforcement of the forum selection clause unreasonable.

The joint venturers may also want to consider the inclusion of a jury-trial waiver clause such as the following:

> THE PARTIES HEREBY WAIVE ANY RIGHT TO TRIAL BY JURY IN ANY PROCEEDING ARISING OUT OF OR RELATING TO THIS AGREEMENT OR ANY OF THE CONTEMPLATED TRANSACTIONS, WHETHER NOW EXISTING OR HEREAFTER ARISING, AND WHETHER SOUNDING IN CONTRACT, TORT OR OTHERWISE. ANY OF THEM MAY FILE A COPY OF THIS PARAGRAPH WITH ANY COURT AS WRITTEN EVIDENCE OF THE KNOWING, VOLUNTARY AND BARGAINED-FOR AGREEMENT AMONG THE PARTIES IRREVOCABLY TO WAIVE TRIAL BY JURY, AND ANY PROCEEDING WHATSOEVER BETWEEN THEM RELATING TO THIS AGREEMENT OR ANY OF THE CONTEMPLATED TRANSACTIONS SHALL INSTEAD BE TRIED IN A COURT OF COMPETENT JURISDICTION BY A JUDGE SITTING WITHOUT A JURY.

The Seventh Amendment to the U.S. Constitution guarantees the fundamental right to a jury trial in ''suits at common law, where the value in controversy shall exceed twenty dollars'' and there is, therefore, a strong presumption against the waiver of the right to a jury trial. *Aetna Ins. Co v. Kennedy*, 301 U.S. 389, 393 (1937) (''courts indulge every reasonable presumption against waiver''). As a result, courts have held that jury-waiver clauses are to be narrowly construed and that any ambiguity is to be decided against the waiver.

Even where the terms of an agreement are heavily negotiated, the drafter may want to anticipate a challenge to the jury waiver clause, particularly if the other person is financially distressed or not particularly sophisticated. *See, e.g. Phoenix Leasing*, 843 F. Supp. 1379 (D. Nev. 1994), *aff'd*, 89 F.3d 846 (9th Cir. 1996), where the court held that the waiver was voluntary because some of the agreement's terms were negotiated, evidencing bargaining power, and finding that knowledge by the other person that funds were ''badly needed'' did not indicate gross disparity of bargaining power The Phoenix Leasing court also enforced the waiver because it found that the defendant was ''experienced, professional and sophisticated in business dealings'' and ''all parties were represented by lawyers.'' Similarly, in *Bonfield v. AMCO Transmissions, Inc.*, 717 F. Supp. 589, 595–96 (N.D. Ill. 1989), the court found the waiver voluntary (a) because the person challenging the waiver was an experienced businessman who chose not to have lawyers review the agreement, and (b) the defendant had explained the purpose of the jury waiver to the person challenging the waiver in terms of ''the large verdicts juries tend to award'' to which the court noted, ''[i]f that did not grab [the] attention [of the person objecting to the waiver], nothing would.'' *But see Whirlpool Financial Corp. v. Sevaux*, 866 F. Supp. 1102, 1106 (N.D. Ill. 1994), where the court held that the waiver was not voluntary in the light of evidence showing that the person challenging the jury waiver clause was desperate for cash and had no ability to change the inconspicuous terms of a standardized contract.

17.4 Waiver. Neither the failure nor any delay by any Person in exercising any right, power or privilege under this Agreement or the documents referred to in this Agreement will operate as a waiver of the right, power or privilege, and no single or partial exercise of any right, power or privilege will preclude any other or further exercise of the right, power or privilege or the exercise of any other right, power or privilege. To the extent permitted by Applicable Law: (a) no claim or right arising out of this Agreement or the documents referred to in this Agreement can be discharged by one Person, in whole or in part, by a

waiver or renunciation of the claim or right unless in writing signed by the other Person; (b) no waiver that may be given by a Person will be applicable except in the specific instance for which it is given; and (c) no notice to or demand on one Person will be deemed to be a waiver of any obligation of that Person or of the right of the Person giving the notice or demand to take further action without notice or demand as provided in this Agreement or the documents referred to in this Agreement.

Comment

A waiver provision is common in transaction agreements. The waiver provision is intended to defeat arguments that the course of performance or course of dealing with respect to the joint venture dictates the outcome of disputes between the Members and that an immaterial delay prejudices the rights of the other person. In practice, despite the provisions of Section 17.4, the Members need to be concerned with how their actions could be interpreted as an ‘‘acceptance’’ or covenant. Lawyers should consider the relationship between Section 17.4 and the ‘‘time is of the essence’’ provision in Section 17.9.

The drafter may also want to consider the relationship between this provision and the dispute resolution provisions in Article 13 and other specific procedures that set forth exact time tables, particularly with respect to resolution of business disputes or legal claims.

17.5 Entire Agreement and Modification. This Agreement and the Related Agreements (subject in the case of the Pre-Joint Venture Confidentiality Agreement, to Section 16.11 (Pre-Joint Venture Confidentiality Agreement)) (a) supersede all prior agreements between the parties with respect to their subject matter and (b) constitute a complete and exclusive statement of the terms of the agreement between the parties with respect to their subject matter. This Agreement may not be amended except by a written agreement executed by the Members.

Comment

For the effect of integration provisions, see *VGS Inc. v. Castiel*, No. CA 17995, 2003 WL 723285 (Del. Ch. 2003); *cf. Blue Chip Emerald, LLC v. Allied Partners, Inc.* 750 N.Y.S. 2d 291 (2002).

This section provides that the Model JV Agreement (along with the documents referred to in the Model JV Agreement) contains the entire understanding of the Members regarding the Company so that, unless otherwise specified, all prior agreements between the joint venturers relating to the transaction are superseded by (and not incorporated into) the terms of the joint venture agreement. Any conflicts between previous agreements and the joint venture agreement are eliminated. Accordingly, if the joint venturers agree that any pre-existing agreements between the joint venturers regarding the Company should remain in effect, those agreements would have to be carved out (as has been done in the Model JV Agreement with respect to the Pre-Joint Venture Confidentiality Agreement). The Model JV Agreement addresses confidentiality by reference to Section 16.11.

This section also states that the joint venture agreement may be amended only by a written agreement executed by all the Members. This section reflects the principle that a contract required by the Statute of Frauds to be in writing may not be orally modified. The rule prohibiting oral modification of contracts within the Statute of Frauds, however, has not been applied in cases in which there has been partial performance of an oral agreement to modify the written contract, especially if one person's conduct induces another to rely on the modification agreement. Cf. Christine Jolls, *Contracts as Bilateral Commitments: A New Perspective on Contract Modification*, 26 J. Legal Stud. 203 (1997).

17.6 Assignments, Successors. Except as expressly provided in this Agreement (including Article 6 (Transfer Restrictions on Member Interests)), neither Member may assign any of its rights under this Agreement without the prior consent of the other Member. Subject to the preceding sentence, this Agreement will apply to, be binding in all

respects upon and inure to the benefit of the successors and permitted assigns of the Members. The foregoing does not modify Article 6 in any respect.

Comment

Consistent with Article 6, this section requires the other Member's consent before the other may assign its rights under the joint venture agreement. This provision is necessary because the modern rule is that, absent an express provision to the contrary, contract rights are freely assignable. See John Edward Murray, Jr., *Murray on Contracts*, § 138 (3d Ed. 1990). Although the joint venture agreement will be binding upon and will inure to the benefit of the successors and assigns of the joint venturers, the assignment will not release the assignor from its duties and obligations unless the obligee consents to the assignment. *See Id.*, § 140.

Clearly, in the situation of a joint venture the relationship of the joint venturers is very personal and it would be rare for any joint venturer to be willing to have a joint venture member assign its interest in the joint venture without the prior consent of the other joint venturer. The nature of the relationship is different from the typical economic investment relationship in a limited partnership or as a passive investor in a corporation or limited liability company. The joint venture arrangement contemplates active participation by both joint venturers and an ongoing relationship between the two Members.

17.7 No Third Party Rights. Nothing expressed or referred to in this Agreement will be construed to give any Person other than the Members (and the Company) any legal or equitable right, remedy or claim under or with respect to this Agreement or any provision of this Agreement. This Agreement and all of its provisions and conditions are for the sole and exclusive benefit of the Members (and the Company) and their successors and assigns.

Comment

The right of a third party to be considered a third-party beneficiary and enjoy

rights under a contract often depends upon the intention of the contracting parties. *See* Arthur L. Corbin, *Corbin on Contracts*, § 776 (Supp. 1999). Recently, courts have permitted certain groups to enforce agreements as third-party beneficiaries despite the presence of a ''no third-party beneficiaries'' clause in the agreement. *See*, *In re Enron Corp.* [2001–2002 Transfer Binder] Bankr. L. Rep (CCH) ¶ 78,738 (S.D.N.Y. 2002) (shareholders of a target company allowed to sue the acquirer under a merger agreement that the shareholders alleged had been improperly terminated by the acquirer); *Prouty v. Gores Tech. Group*, 18 Cal. Rptr. 3d 178 (Cal. Ct. App. 2004) (employees of target company permitted to enforce certain provisions of acquisition agreement against the acquirer); *Comrie v. Enterasys Networks, Inc*., No. Civ. A 19254 2004 WL 293337 (Del. Ch. Feb. 17, 2004) (employees of target allowed to enforce acquisition agreement as third-party benefici-aries); *but see*, *Merzin v. Provident Fin. Group, Inc*., 311 F. Supp. 2d 674 (S.D. Ohio 2004) (shareholders of target not allowed to enforce acquisition agreement as third-party beneficiaries). For a general discussion of third-party beneficiary and other cases, see the *Annual Survey of Judicial Developments Pertaining to Mergers and Acquisitions* by the Subcommittee on Recent Judicial Developments, Negotiated Acquisitions Committee, ABA Section of Business Law, 60 *THE BUSINESS LAWYER*. 843 (February 2005).

17.8 Severability. If any provision of this Agreement not essential to accomplishing its purposes is held invalid or unenforceable by any court of competent jurisdiction, the other provisions of this Agreement will remain in full force and effect. Any provision of this Agreement held invalid or unenforceable only in part or degree will remain in full force and effect to the extent not held invalid or unenforceable.

Comment

Whether a contract is entire or severable depends upon the parties' intention, the

subject matter of the agreement and the circumstances of the transaction. *See, e.g.*, *Christian v. Christian*, 42 N.Y.2d 63 (1977); *Keene v. Harling*, 61 Cal. 2d 318 (1964); *Heil-wood Fuel Co. v. Manor Real Estate Co.*, 175 A.2d 880 (Pa. 1961); *Knight v. Hamilton*, 233 S.W.2d 969 (Ky. 1950). Under Section 17.8, if a provision of an agreement is held unenforceable, the remaining provisions are separated from the invalid or unenforceable provision and remain in effect. *Cf. Christian*, 42 N.Y.2d at 73 (''Here the parties had a right to and did, by expressly stipulating that if any provision of the separation agreement be held invalid or unenforceable all other[s] shall nevertheless continue in full force, make the agreement within reasonable limits divisible, and there is little room for construction.'').

The language in Section 17.8 may not be effective, however, if the invalid provision constitutes an essential element of the contract. According to the Restatement (Second) of Contracts § 184 (1981):

> (1) If less than all of an agreement is unenforceable . . . a court may nevertheless enforce the rest of the agreement in favor of a party who did not engage in serious misconduct if the performance as to which the agreement is unenforceable is not an essential part of the agreed exchange.
>
> (2) A court may treat only a part of a term as unenforceable under the rule stated in Subsection (1) if the party who seeks to enforce the term obtained it in good faith and in accordance with reasonable standards of fair dealing.

As the comment to this subsection of the Restatement explains:

> If the performance as to which the agreement is unenforceable is an essential part of the agreed exchange, the inequality will be so great as to make the entire agreement unenforceable. Under Subsection (1), however, if that performance is

not an essential part of the agreed exchange, a court may enforce all but the part that contravenes public policy. For example, a promise not to compete that is unreasonably in restraint of trade will often not invalidate the entire agreement of which it is a part. Whether the performance is an essential part of the agreed exchange depends on its relative importance in the light of the entire agreement between the parties.

The joint venturers may also want to consider inserting a provision calling for judicial reformation of the agreement to modify the invalid provision to achieve the joint venturers' intention. This practice is common with respect to covenants not to compete. A Member may want to consider whether it will want to rescind the entire joint venture agreement if a major, yet nonessential, provision is held to be invalid or unenforceable.

17.9 Time is of the Essence; Computation of Time. Time is of the essence of each and every provision of this Agreement. If the last day for the exercise of any privilege or the discharge of any duty under this Agreement falls on a day that is not a Business Day, then the Person having such privilege or duty will have until 5:00 p.m. (its local time) on the next succeeding Business Day to exercise its privilege or to discharge its duty.

17.10 Expenses. Each Member will bear its own expenses incurred in connection with the negotiation, drafting, implementation and performance of this Agreement except as provided in Section 8.3(b)(iii) (Legal Fees & Expenses).

17.11 Governing Law. Except for the application of the United States Arbitration Act (9 U.S.C. §§ 1–16) to dispute resolution as provided in this Agreement, this Agreement, including issues arising out of or related to this Agreement, will be governed by the laws of _____ the State [or Commonwealth] of (except the laws of that jurisdiction that would render such choice of law ineffective).

Comment

This section allows the joint venturers to select the law that will govern the

contractual rights and obligations of the Members. (The joint venturers may want to specify a different choice of law with regard to non-competition provisions.) Without a choice-of-law provision a court most likely will apply the law of the state in which the Company was formed. An interesting case is *VantagePoint Venture Partners 1996 v. Examen, Inc*., 871 A.2d 1108 (Del. 2005) (refusing to apply California law to a Delaware corporation that qualified as a ''quasi-California'' corporation under California law, holding that the internal affairs doctrine requires that the law of the state of incorporation applies to matters relating to the relationship among or between a corporation and its officers, directors and stockholders).

Several states have now gone a step further by enacting statutes enabling parties to a written contract to specify that the law of that state would govern the parties' relationship, notwithstanding the lack of any other connection to that state. *See, e.g.*, Del. Code Ann. tit. 6, § 2708; Fla. Stat. Ann. § 685.101; 735 Ill. Comp. Stat. 105/5–5; N.Y. Gen. Oblig. Law § 5–1401; and Ohio Rev. Code Ann. § 2307.39. These statutes recognize that sophisticated parties may have valid reasons to choose the law of a given jurisdiction to govern their relationship, even if the chosen jurisdiction is not otherwise involved in the transaction.

New York's General Obligations Law § 5–1401 provides that the parties to an agreement involving a transaction having a value of at least $250,000 may provide that the agreement will be governed by New York law. A number of commentators have questioned whether this statute would survive a constitutional analysis in a situation in which neither party had any significant New York contacts.

Del. Code Ann. tit. 6, § 2708(a) provides that

> *The parties to any contract . . . may agree in writing that the contract . . . shall be governed by . . . the laws of this State, without regard to principles of conflict of laws . . . if* the parties **either as provided by law or in the manner specified in**

such writing are, (i) subject to the jurisdiction of the courts of, or arbitration in, Delaware and, (ii) may be served with legal process. (Emphasis added)

Section 2708(c)(ii) states that § 2708(a) does not apply unless the contract in question involves at least $100,000. The underlined part of § 2708(a) suggests that, unless the parties are subject to the jurisdiction of the Delaware courts by operation of law (presum-ably because they or the transaction have some significant Delaware contacts—such as being incorporated in Delaware), they can rely on § 2708(a) only if they agree in the contract to subject themselves to the jurisdiction of the Delaware courts. Presumably the requirement would be satisfied if the parties agreed to the *non-exclusive* jurisdiction of the Delaware courts.

Note that Section 17.11 provides *''except any laws of that jurisdiction that would render such choice of law ineffective,''* instead of *''without regard to choice of law rules''* because the latter eliminates the benefits of the statutes described above.

Practitioners may wish to consider the use of one of these statutes in appropriate circumstances, perhaps to choose a neutral jurisdiction if the choice of law negotiation has become heated. These statutes are a relatively new development, however, and as such, are not free from uncertainty. Perhaps the most significant uncertainty is whether the choice of law based upon such a statute would be respected by a court of a different jurisdiction. Although valid reasons (such as protecting the parties' expectations) suggest their choice is likely to be respected, the outcome is not yet clear.

17.12 Counterparts. This Agreement may be executed in one or more counterparts, each of which will be deemed to be an original copy of this Agreement and all of which, when taken together, will be deemed to constitute one and the same agreement.

Comment

This section, which permits execution in counterparts, is common in transaction agreements. It is inserted for the convenience of the joint venturers and

facilitates execution of the agreement when the signatories are not available at the same time or place. This section does not alter the effective date specified on the initial page of the Model JV Agreement.

Some provisions regarding execution in one or more counterparts also provide that facsimile transmission shall constitute effective execution and delivery of the agreement and may be used in lieu of the original agreement for all purposes. Provisions allowing exchange of copies and signature pages by facsimile recognize the increasing trend to rely on facsimile transmission for execution and delivery of transaction agreements. The essential elements to the formation of a contract are an offer, acceptance and manifestation of assent or meeting of the minds. When an offer upon spec-ified terms is accepted without conditions, and acceptance is communicated to the other party without unreasonable delay, a contract arises. The offeror may prescribe conditions on the method of acceptance. Restatement (Second) of Contracts § 30.

[signatures are on next page]

DULY EXECUTED BY the parties on [as of] the date first written above.

Large Member

By: _____

Name: _____

Title: _____

Small Member

By: _____

Name: _____

Title: _____