ANATOMY OF A DEAL – JOINT VENTURE FORMATION AND GOVERNANCE

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I. INTRODUCTION

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

Because a joint venture is commonly thought of as a limited duration general partnership formed for a specific business activity, the owners of a joint venture are sometimes referred to

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1 *See* Byron F. Egan, *EGAN ON ENTITIES: Corporations, Partnerships and Limited Liability Companies in Texas* (Second Edition 2018 ["*EGAN ON ENTITIES*"]) at pages 29-36; Byron F. Egan, *Joint Venture Formation*, 44 Tex. J. Bus. Law 129 (2012); James R. Bridges and Leslie E. Sherman, *Structuring Joint Ventures*, 4 Insights 17 (Oct. 1990); David Ernst and Stephen I. Glover, *Combining Legal and Business Practices to Create Successful Strategic Alliances*, 11 Insights 6 (Oct. 1997); Stephen I. Glover, *Joint Ventures and Opportunity Doctrine Problems*, 9 Insights 9 (Nov. 1995); Warren S. de Wied, *Structuring Strategic Equity Investments*, 1 No. 8 M&A Law. 7 (Jan. 1998).

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

3 *See* JOINT VENTURE TASK FORCE OF NEGOTIATED ACQUISITIONS COMMITTEE, MODEL JOINT VENTURE AGREEMENT WITH COMMENTARY (Am. Bar Ass'n., 2006) (the **"*ABA Model Joint Venture Agreement*"**).

4 *See EGAN ON ENTITIES* at pages 29-36; Byron F. Egan, *Choice of Entity Decision Tree*, TexasBarCLE and Business Law Section of State Bar of Texas program on Choice and Acquisition of Entities in Texas, May 22, 2015, *available at* http://web1.amchouston.com/flexshare/003/BusinessLaw/2015/ChoiceofEntityDecisionTree_BE.pdf (**"*Business Entities Paper*"**) at pages 49, 430-436.

herein as ***"partners"*** or ***"venturers,"*** and the joint venture as the ***"entity," "partnership"*** or ***"venture,"*** in each case irrespective of the particular form of entity or other structure selected for the joint venture. Today the LLC is typically the entity of choice for the formation of a joint venture because, as discussed below, it offers structuring flexibility and limited owner liability for joint venture activities under both the Texas Business Organizations Code (***"TBOC"***), which now governs all LLCs formed under Texas law,[5] and the Delaware Limited Liability Company Act (the ***"DLLCA"***).[6]

II. CHOICE OF ENTITY

A. Alternatives

A joint venture may take the form of:

(1) Contractual Relationship Not Constituting an Entity Recognized by Statute. The joint venturers may operate under a relationship such as a contractual revenue-sharing joint venture, a lease, a creditor/debtor relationship or some other relationship not constituting an entity. A risk to this structure is that a court will impose general partnership duties or liabilities on the venturers if their relationship is found to constitute "an association of two or more persons to operate a business as co-owners for a profit" (the traditional definition of a partnership) regardless of how the venturers characterize and document their relationship.[7] In determining whether the relationship is a partnership, the following factors are considered:

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5 LLCs formed under Texas law are now governed by Title 3 and pertinent provisions of Title 1 of the TBOC. TBOC §§ 401.001, 402.003. The TBOC provisions applicable to LLCs may be officially and collectively referred to as "Texas Limited Liability Company Law." TBOC § 1.008(e).

6 Del. Code Ann. tit. 6 § 18-101 *et. seq*.

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

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

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

- Receipt or right to receive a share of profits;
- Expression of an intent to be partners;
- Participation or right to participate in control of the business;
- Sharing or agreeing to share losses or liabilities; or
- Contributing or agreeing to contribute money or property to the business.[8]

In weighing the foregoing five factors, courts look at the totality of the circumstances, and do not require conclusive evidence of all of the factors to prove the existence of a partnership.[9]

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

(2) General Partnership. A general partnership is an unincorporated association of two or more persons to operate a business as co-owners for profit that is not formed under another statute.[10] The definition of a partnership under Texas general partnership statutes includes a "joint venture" or any other named association that satisfies the definition of "partnership."[11] A joint venture may be legally nothing more than a limited purpose general partnership, although a joint venture may be organized as a corporation, limited partnership or LLC.[12] A general partnership may become a limited liability partnership (***"LLP"***), which is a general partnership in which the partners are not vicariously liable to third parties for some or all partnership obligations if it makes the requisite filings with the appropriate state secretary of state and complies with certain other state statutory requirements.[13]

(3) Limited Partnership. A limited partnership is a partnership having at least two partners including at least one limited partner and at least one general partner, and that files a certificate of limited partnership with the applicable state secretary of state.[14] A limited partnership can be structured in some states as a limited liability limited partnership (***"LLLP"***), which is a

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be used as the joint venture entity and the LLC company agreement could define, or in Delaware eliminate, fiduciary duties), and (iii) written agreements should be understood and followed literally.

8 *See Brown v. Keel*, No. 01-10-00936-CV, 2012 WL 760933, at *4 (Tex. App.—Houston [1st Dist.] March 8, 2012, no pet.) (citing *Ingram v. Deere*, 288 S.W. 3d 886, 896 (Tex. 2009)); *Westside Wrecker Serv., Inc. v. Skafi*, 361 S.W.3d 153,166 (Tex. App.—Houston [1st Dist.] 2011, pet. denied); *Hoss v. Alardin*, 338 S.W.3d 635, 641-42 (Tex. App.—Dallas 2011, pet. denied). *See also* Business Entities Paper, *supra* note 4, at 390-312.

9 *Ingram v. Deere*, 288 S.W.3d 886, 895-96 (Tex. 2009).

10 Business Entities Paper, *supra* note 4, at 309.

11 TBOC § 152.051(b); Texas Revised Partnership Act (***"TRPA"***) § 2.02.

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

13 Business Entities Paper, *supra* note 4, at 401-430.

14 *Id.* at 321-346.

limited partnership in which general partners are not vicariously liable to third parties for some or all partnership obligations.[15]

(4) Limited Liability Company. A limited liability company (***"LLC"***) is an unincorporated organization formed by one or more persons filing a certificate of formation or articles of organization under a state limited liability company act.[16] None of the members of an LLC is personally liable to a third party for the obligations of the LLC solely by reason of being a member.[17]

(5) Corporation. A corporation is a business organization usually formed under a state corporation law, but occasionally is formed under federal law such as certain banking organizations.[18]

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

- How the entity and the venturers will be taxed under federal and state law;[19] and

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15 *Id.* at 418.

16 *Id.* at 346-401.

17 *Id.* at 384-389.

18 *Id.* at 50-85.

19 Federal and state taxation of an entity and its owners for entity income is a major factor in the selection of the form of entity for a particular situation. Under the United States (***"U.S."***) Internal Revenue Code of 1986, as amended (the ***"IRC"***), and the ***"Check-the-Box Regulations"*** promulgated by the Internal Revenue Service (***"IRS"***) (Treasury Regulations §§ 301.7701-1, -2 and -3), an unincorporated business entity may be classified as an "association" taxable as a corporation subject to income taxes at the corporate level at a flat rate of 21% of taxable net income, which is in addition to any taxation which may be imposed on the owner as a result of distributions from the business entity. *EGAN ON ENTITIES* at pages 623-629. Alternatively, the entity may be classified as a partnership, a non-taxable "flow-through" entity in which taxation is imposed only at the ownership level. Although a corporation organized under a state law like the DGCL or the TBOC is classified only as a corporation for IRC purposes, an LLC or partnership may elect whether to be classified as a partnership or a corporation for IRC purposes. *Id.* A single-owner LLC is disregarded as a separate entity for federal income tax purposes unless it elects otherwise. *Id.*

In addition to federal tax laws, an entity and its advisors must comply with federal anti-money laundering and terrorist regulations. An entity and its advisors are charged with reviewing and complying with the Specially Designated Nationals List (***"SDN List"***) maintained by the Office of Foreign Assets Control (***"OFAC"***) within the U.S. Department of Treasury. U.S. citizens and companies (subject to certain exclusions typically conditioned upon the issuance of a special license) are precluded from engaging in business with any individual or entity listed on the SDN List. The SDN List and OFAC guidance are available on the OFAC website at https://www.treasury.gov/resource-center/sanctions/SDN-List/Pages/default.aspx (scroll down to select the desired sorting option, including viewing the full SDN List).

Texas does not have a state personal income tax. The Texas Legislature has replaced the Texas franchise tax on corporations and LLCs with a novel business entity tax called the ***"Margin Tax,"*** which is imposed on all business entities other than general partnerships wholly owned by individuals and certain "passive entities." Essentially, the calculation of the Margin Tax is based on a taxable entity's, or unitary group's, gross receipts after deductions for (x) W-2 compensation capped at $390,000 per employee; or (y) cost of goods sold; or (z) $ 1 million; provided that the "tax base" for the Margin Tax may not exceed 70% of the entity's total revenues. This "tax base" is apportioned to Texas by multiplying the tax base by a fraction of which the numerator is Texas gross receipts and the denominator is aggregate gross receipts. The tax rate applied to

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

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

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

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

B. LLC Entity of Choice for Joint Ventures

(1) Why LLC Frequently Selected. Increasingly, the LLC is the form of entity chosen for domestic joint ventures in the U.S.[20] The allure of the LLC is its unique ability to bring together in a single business organization the best features of all other business forms. The owners, who are called ***"Members"*** in both the TBOC and the DLLCA, of a properly structured LLC can obtain both a corporate-styled liability shield and the pass-through tax benefits of a partnership. All equity holders of an LLC have the limited liability of corporate shareholders even if they

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the Texas portion of the tax base for all taxpayers is 0.75%, except that a narrowly defined group of retail and wholesale businesses will pay at rate of 0.375%. For calendar year taxpayers, the Margin Tax is payable annually on May 15 of each year (except that the Comptroller has extended the date for 2020 to July 15) based on entity income for the year ending the preceding December 31. *See* EGAN ON ENTITIES at pages 649-673..

[20] Rodney D. Chrisman, *LLCs are the New King of the Hill: An Empirical Study of the Number of New LLCs, Corporations, and LPs Formed in the United States between 2004-2007 and How LLCs Were Taxed for Tax Years 2002-2006*, XV FORDHAM J. CORP. & FIN. L. 459 (2010), *available at* http://www.rodneychrisman.com/wp-content/uploads/2010/07/Chrisman-JCI2-FJCFL-XV.2.pdf (last visited April 6, 2020).

participate in the business of the LLC.[21] Under the Check-the-Box Regulations, a domestic LLC with two or more members typically would be treated for federal income tax purposes as a partnership.[22] An LLC is subject to Texas Margin Tax.[23]

An underlying premise of the Texas and Delaware LLC statutes is that the LLC is based in large part upon a contract between its members,[24] which is similar to a partnership agreement, and is called a ***"Company Agreement"*** under the TBOC and a ***"Limited Liability Company Agreement"*** (referred to herein as an ***"LLC Agreement"***) under the DLLCA.[25] As a result,

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21 TBOC §§ 101.114.

22 *See supra* note 19..

23 *Id.*

24 Joint Task Force of the Committee on LLCs, Partnerships and Unincorporated Entities and the Committee on Taxation, ABA Section of Business Law, *Model Real Estate Development Operating Agreement with Commentary*, 63 Bus. Law. 385 (February 2008).

25 TBOC § 101.052 provides

> (a) Except as provided by Section 101.054, the company agreement of a limited liability company governs:
>
> (1) the relations among members, managers, and officers of the company, assignees of membership interests in the company, and the company itself; and
>
> (2) other internal affairs of the company.
>
> (b) To the extent that the company agreement of a limited liability company does not otherwise provide, this title and the provisions of Title 1 applicable to a limited liability company govern the internal affairs of the company.
>
> (c) Except as provided by Section 101.054, a provision of this title or Title 1 that is applicable to a limited liability company may be waived or modified in the company agreement of a limited liability company.
>
> (d) The company agreement may contain any provisions for the regulation and management of the affairs of the limited liability company not inconsistent with law or the certificate of formation.
>
> (e) A company agreement may provide rights to any person, including a person who is not a party to the company agreement, to the extent provided by the company agreement.
>
> (f) A company agreement is enforceable by or against the limited liability company, regardless of whether the company has signed or otherwise expressly adopted the agreement.

DLLCA § 18-101(9) provides:

> (9) "Limited liability company agreement" means any agreement (whether referred to as a limited liability company agreement, operating agreement or otherwise), written, oral or implied, of the member or members as to the affairs of a limited liability company and the conduct of its business. A member or manager of a limited liability company or an assignee of a limited liability company interest is bound by the limited liability company agreement whether or not the member or manager or assignee executes the limited liability company agreement. A limited liability company is not required to execute its limited liability company agreement. A limited liability company is bound by its limited liability company agreement whether or not the limited liability

fundamental principles of freedom of contract imply that the owners of an LLC have maximum freedom to determine the internal structure and operation of the LLC under both the TBOC[26] and the DLLCA.[27] Most of the provisions relating to the organization and management of an LLC and

company executes the limited liability company agreement. A limited liability company agreement of a limited liability company having only 1 member shall not be unenforceable by reason of there being only 1 person who is a party to the limited liability company agreement. A limited liability company agreement is not subject to any statute of frauds (including § 2714 of this title). A limited liability company agreement may provide rights to any person, including a person who is not a party to the limited liability company agreement, to the extent set forth therein. A written limited liability company agreement or another written agreement or writing:

a. May provide that a person shall be admitted as a member of a limited liability company, or shall become an assignee of a limited liability company interest or other rights or powers of a member to the extent assigned:

1. If such person (or a representative authorized by such person orally, in writing or by other action such as payment for a limited liability company interest) executes the limited liability company agreement or any other writing evidencing the intent of such person to become a member or assignee; or

2. Without such execution, if such person (or a representative authorized by such person orally, in writing or by other action such as payment for a limited liability company interest) complies with the conditions for becoming a member or assignee as set forth in the limited liability company agreement or any other writing; and

b. Shall not be unenforceable by reason of its not having been signed by a person being admitted as a member or becoming an assignee as provided in paragraph (7)a. of this section, or by reason of its having been signed by a representative as provided in this chapter.

[26] An underlying premise of the TBOC is that the LLC is based in large part upon a contract between its Members, similar to a partnership agreement. As a result, fundamental principles of freedom of contract imply that the owners of an LLC have maximum freedom to determine the internal structure and operation of the LLC. TBOC §§ 1.002(53), 101.101, 101.102.

[27] DLLCA § 18-1101(b), (c), (d) and (e) provides:

(b) It is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.

(c) 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.

(d) Unless otherwise provided in a limited liability company agreement, a member or manager or other person shall not be liable 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 for breach of fiduciary duty for the member's or manager's or other person's good faith reliance on the provisions of the limited liability company agreement.

the terms governing its equity interests are contained in the LLC's Company Agreement or LLC Agreement, which will typically contain provisions similar to those in limited partnership agreements and corporate bylaws,[28] and may also constitute the joint venture agreement for a joint venture organized as an LLC.[29]

(2) Management. The TBOC requires, and the DLLCA encourages, that an LLC specify in its governing documents whether it is to be managed by its Members or by Managers.[30] The ***"Managers"*** of an LLC are generally analogous to directors of a corporation and are elected by the Members in the same manner as corporate directors are elected by shareholders.[31] The business and affairs of an LLC with Managers are managed under the direction of its Managers, who can function as a board of directors or Managers (***"Board"***) and may designate officers and other agents to act on behalf of the LLC.[32]

Under the TBOC and the DLLCA, any "person" may become a Member or Manager.[33] Because of the broad definition given to "person" by the TBOC and the DLLCA, any individual, corporation, partnership, LLC or other person may become a Member or Manager.[34] Thus, it is possible to have an LLC with a corporation as the sole Manager just as it is possible to have a limited partnership with a sole corporate general partner.[35] The certificate of formation may provide that the management of the business and affairs of the LLC may be reserved to its Members, and thus that the LLC be managed by its Members who may choose to elect officers for the LLC to manage its day to day operations or may manage the LLC directly as Members through its own officers.[36] Thus an LLC could be organized to be run without Managers, as in the case of a close corporation, or it could be structured so that the day to day operations are run by Managers

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> (e) A limited liability company agreement may provide for the limitation or elimination of any and all liabilities for breach of contract and breach of duties (including fiduciary duties) of a member, manager or other person 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; provided, that a limited liability company agreement may not limit or eliminate liability for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing.

28 TBOC § 101.052; Joint Task Force of the Committee on LLCs, Partnerships and Unincorporated Entities and the Committee on Taxation, ABA Section of Business Law, *Model Real Estate Development Operating Agreement with Commentary*, 63 Bus. Law. 385 (February 2008).

29 *See* JOINT VENTURE TASK FORCE OF NEGOTIATED ACQUISITIONS COMMITTEE, *supra* note 3, at 38.

30 TBOC § 3.010; DLLCA § 18-402.

31 *See* TBOC § 101.302.

32 TBOC §§ 101.251-101.253; DLLCA § 18-402.

33 TBOC § 3.010; DLLCA § 18-301.

34 "Person" is defined in TBOC § 1.002(69-b) as follows:

> (69-b) "Person" means an individual or a corporation, partnership, limited liability company, business trust, trust, association, or other organization, estate, government or governmental subdivision or agency, or other legal entity, or a series of a domestic limited liability company or foreign entity.

"Person" is likewise broadly defined in DLLCA § 18-101(14).

35 TBOC § 101.302; TEX. GOV'T CODE § 311.005(2).

36 *See* TBOC § 101.251.

but Member approval is required for significant actions as in the case of many joint ventures and closely held corporations.

The Company Agreement should specify who has the authority to obligate the LLC contractually or to empower others to do so.[37] It should dictate the way in which the Managers or Members, whichever is authorized to manage the LLC, are to manage the LLC's business and affairs.[38] Under Texas law, the following are agents of an LLC: (1) any officer or other agent who is vested with actual or apparent authority; (2) each Manager (to the extent that management of the LLC is vested in that Manager); and (3) each Member (to the extent that management of the LLC has been reserved to that Member).[39] Texas law further provides that an act (including the execution of an instrument in the name of the LLC) for the purpose of apparently carrying on in the usual way the business of the LLC by any of such persons binds the LLC unless (1) the person so acting lacks authority to act for the LLC and (2) the third party with whom the LLC is dealing is aware of the actor's lack of authority.[40] Rather than providing that Managers are agents except to the extent otherwise provided in its governing documents, the DLLCA provides that LLC management power is vested in the Members except as provided in the LLC Agreement.[41]

(3) Fiduciary Duties.

(a) Texas. The TBOC does not address specifically whether Manager or Member fiduciary or other duties exist or attempt to define them,[42] but the TBOC implicitly

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37 TBOC § 101.252.

38 There follows a sample LLC Agreement provision vesting the power to manage the LLC in a Board of Managers and providing that no member of the Board shall have power to bind the LLC unless the person is also an officer:

> A board of managers of the Company (the ***"Board"*** or ***"Board of Managers"***) is hereby established and shall be composed of natural Persons (each such Person, a ***"Manager"***) who shall be appointed in accordance with the provisions of Section ___. The business and affairs of the Company shall be managed, operated and controlled by or under the direction of the Board, and the Board shall have, and is hereby granted, the full and complete power, authority and discretion for, on behalf of and in the name of the Company, to take such actions as it may in its sole discretion deem necessary or advisable to carry out any and all of the objectives and purposes of the Company, subject only to the terms of this Agreement. The Chairman of the Board shall preside over meetings of the Board. The Board of Directors shall be a "Manager" of the Company within the meaning of §18-101(10) of the Delaware Act. Notwithstanding the use herein of the term "Manager" to define an individual who is a member of the Board, no individual Manager shall be a "Manager" of the Company and no individual Manager shall have any right, power or authority, acting individually, to bind the Company; provided, however, that if any Manager is an Officer, such Manager acting in his or her capacity as an Officer shall have the authority to bind the Company for authorized limited liability company actions under such Officer's control, subject to the provisions of this Agreement.

39 TBOC § 101.254(a).

40 TBOC § 101.254(b).

41 DLLCA § 18-402.

42 *See* Elizabeth M. McGeever, *Hazardous Duty? The Role of the Fiduciary in Noncorporate Structures*, 4 BUS. L. TODAY 51, 53 (Mar.–Apr.1995); Robert R. Keatinge et al., *The Limited Liability Company: A Study of the Emerging Entity*, 47 BUS. LAW. 375, 401 (1992) (noting that LLC statutes usually do not specify fiduciary duties of Members or Managers).

recognizes that these duties may exist in statutory provisions which permit them to be expanded, modified, restricted or waived, and liabilities for the breach thereof to be limited or eliminated, in the Company Agreement.[43] The duty of Managers in a Manager-managed LLC and Members in

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[43] TBOC §§ 101.052, 101.054 101.401 and 7.001 provide that a Company Agreement may expand, modify, restrict or waive fiduciary duties as follows:

Sec. 101.052. COMPANY AGREEMENT.

> (a) Except as provided by Section 101.054, the company agreement of a limited liability company governs:
>
> (1) the relations among members, managers, and officers of the company, assignees of membership interests in the company, and the company itself; and
>
> (2) other internal affairs of the company.
>
> (b) To the extent that the company agreement of a limited liability company does not otherwise provide, this title and the provisions of Title 1 applicable to a limited liability company govern the internal affairs of the company.
>
> (c) Except as provided by Section 101.054, a provision of this title or Title 1 that is applicable to a limited liability company may be waived or modified in the company agreement of a limited liability company.
>
> (d) The company agreement may contain any provisions for the regulation and management of the affairs of the limited liability company not inconsistent with law or the certificate of formation.
>
> (e) A company agreement may provide rights to any person, including a person who is not a party to the company agreement, to the extent provided by the company agreement.
>
> (f) A company agreement is enforceable by or against the limited liability company, regardless of whether the company has signed or otherwise expressly adopted the agreement.

Sec. 101.054. WAIVER OR MODIFICATION OF CERTAIN STATUTORY PROVISIONS PROHIBITED; EXCEPTIONS.

> (a) Except as provided by this section, the following provisions may not be waived or modified in the company agreement of a limited liability company:
>
> (1) this section;
>
> (2) Section 101.101(b)[Members Required], 101.151 [Requirements for Enforceable Promise [to make contribution]], 101.206 [Prohibited Distribution; Duty to Return], 101.501 [Supplemental Records Required for Limited Liability Companies], or 101.502 [Right to Examine Records and Certain Other Information];
>
> (3) Chapter 1 [Definitions and Other General Provisions], if the provision is used to interpret a provision or define a word or phrase contained in a section listed in this subsection;
>
> (4) Chapter 2 [Purposes and Power of Domestic Entity], except that Section 2.104(c)(2) [Power to Make Guaranties], 2.104(c)(3) [Power to Make Guaranties], or 2.113 [Limitation on Powers] may be waived or modified in the company agreement;

(5) Chapter 3 [Formation and Governance], except that Subchapters C [Governing Persons and Officers] and E [Certificates Representing Ownership Interest] may be waived or modified in the company agreement; or

(6) Chapter 4 [Filings], 5 [Names of Entities; Registered Agents and Registered Offices], 10 [Mergers, Interest Exchanges, Conversions, and Sales of Assets], 11 [Winding Up and Termination of Domestic Entity], or 12 [Administrative Powers], other than Section 11.056 [Supplemental Provisions for Limited Liability Company].

(b) A provision listed in Subsection (a) may be waived or modified in the company agreement if the provision that is waived or modified authorizes the limited liability company to waive or modify the provision in the company's governing documents.

(c) A provision listed in Subsection (a) may be modified in the company agreement if the provision that is modified specifies:

(1) the person or group of persons entitled to approve a modification; or

(2) the vote or other method by which a modification is required to be approved.

(d) A provision in this title or in that part of Title 1 [General Provisions] applicable to a limited liability company that grants a right to a person, other than a member, manager, officer, or assignee of a membership interest in a limited liability company, may be waived or modified in the company agreement of the company only if the person consents to the waiver or modification.

(e) The company agreement may not unreasonably restrict a person's right of access to records and information under Section 101.502 [Right to Examine Records and Certain Other Information].

Sec. 101.401. EXPANSION OR RESTRICTION OF DUTIES AND LIABILITIES

The company agreement of a limited liability company may expand or restrict any duties, including fiduciary duties, and related liabilities that a member, manager, officer, or other person has to the company or to a member or manager of the company.

Sec. 7.001. LIMITATION OF LIABILITY OF GOVERNING PERSON.

(a) Subsections (b) and (c) apply to:

(1) a domestic entity other than a partnership or limited liability company;

(2) another organization incorporated or organized under another law of this state; and

(3) to the extent permitted by federal law, a federally chartered bank, savings and loan association, or credit union.

(b) The certificate of formation or similar instrument of an organization to which this section applies may provide that a governing person of the organization is not liable, or is liable only to the extent provided by the certificate of formation or similar instrument, to the organization or its owners or members for monetary damages for an act or omission by the person in the person's capacity as a governing person.

(c) Subsection (b) does not authorize the elimination or limitation of the liability of a governing person to the extent the person is found liable under applicable law for:

(1) a breach of the person's duty of loyalty, if any, to the organization or its owners or members;

(2) an act or omission not in good faith that:

a Member-managed LLC to the LLC is generally assumed to be fiduciary in nature, measured by reference to the fiduciary duties of corporate directors in the absence of modification in the Company Agreement and owed to the LLC. The fiduciary duties of Managers could also be measured by reference to partnership law or the law of agency.[44]

By analogy to corporate directors, Managers would have the duties of obedience, care and loyalty and should have the benefit of the business judgment rule.[45] Much like a corporate

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> (A) constitutes a breach of duty of the person to the organization; or
>
> (B) involves intentional misconduct or a knowing violation of law;
>
> (3) a transaction from which the person received an improper benefit, regardless of whether the benefit resulted from an action taken within the scope of the person's duties; or
>
> (4) an act or omission for which the liability of a governing person is expressly provided by an applicable statute.
>
> (d) The liability of a governing person may be limited or eliminated [~~restricted~~]:
>
> (1) in a general partnership by its partnership agreement to the same extent Subsections (b) and (c) permit the limitation or elimination of liability of a governing person of an organization to which those subsections apply and to the additional extent permitted under Chapter 152;
>
> (2) in a limited partnership by its partnership agreement to the same extent Subsections (b) and (c) permit the limitation or elimination of liability of a governing person of an organization to which those subsections apply and to the additional extent permitted under Chapter 153 and, to the extent applicable to limited partnerships, Chapter 152; and
>
> (3) in a limited liability company by its certificate of formation or company agreement to the same extent Subsections (b) and (c) permit the limitation or elimination of liability of a governing person of an organization to which those subsections apply and to the additional extent permitted under Section 101.401.

Thus, the TBOC § 7.001 allows the elimination of liabilities – to a specified and limited extent – but does not allow the elimination of fiduciary duties; however, TBOC §§ 101.052, 101.054 and 101.401 read together provide that fiduciary duties may be expanded, modified, restricted or waived in a company agreement. Equitable remedies may exist to address acts for which monetary liability has been eliminated by a company agreement. *See* Cliff Ernst and Elizabeth S. Miller, *Model Company Agreements* (2020) https://www.baylor.edu/law/facultystaff/doc.php/249883.PDF.

[44] *See* American Law Institute, RESTATEMENT (SECOND) OF AGENCY § 13 (1958) ("An agent is a fiduciary with respect to matters within the scope of his agency"), 387 ("Unless otherwise agreed, an agent is subject to a duty to his principal to act solely for the benefit of the principal in all matters connected with his agency"), 393 ("Unless otherwise agreed, an agent is subject to a duty not to compete with the principal concerning the subject matter of his agency"), 394 ("Unless otherwise agreed, an agent is subject to a duty not to act or to agree to act during the period of his agency for persons whose interests conflict with those of the principal in matters in which the agent is employed"), and 395 ("Unless otherwise agreed, an agent is subject to a duty to the principal not to use or to communicate information confidentially given him by the principal or acquired by him during the course of or on account of his agency or in violation of his duties as agent, in competition with or to the injury of the principal, on his own account or on behalf of another, although such information does not relate to the transaction in which he is then employed, unless the information is a matter of general knowledge"). *See also* Elizabeth S. Miller, *Practical Pitfalls in Drafting Texas Limited Liability Company Agreements*, 45:1 TEX. J. BUS. L. 27 (2012) ("Absent provisions in the company agreement otherwise, managers and managing members would seemingly owe the common law fiduciary duties of an agent to the LLC as principal, even without resort to analogies to corporate or partnership law.").

[45] *See* Business Entities Paper notes 791-804 and related text.

director who, in theory, represents all of the shareholders of the corporation rather than those who are responsible for his being a director and in the absence of a Company Agreement provision to the contrary, a Manager should be deemed to have a fiduciary duty to the LLC and all of its Members as a group. Whether Members owe a fiduciary duty to the other Members or the LLC will likely be determined by reference to corporate principles in the absence of controlling provisions in the certificate of formation or Company Agreement.[46]

The TBOC allows LLC Company Agreements to expand, modify, restrict or waive the duties (including fiduciary duties) and liabilities of Members, Managers, officers and other persons to the LLC or to Members or Managers of the LLC.[47] This provision of Texas law was designed, in the same vein as the DLLCA from which it drew inspiration, to allow LLCs the flexibility to address fiduciary duties through contract principles.[48] Like the DLLCA which allows an LLC agreement to eliminate fiduciary duties (but not the contractual duty of good faith and fair dealing),[49] the TBOC permits an LLC Company Agreement to expand, modify, restrict or waive

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46 *See Allen v. Devon Energy Holdings, L.L.C.*, 367 S.W.3d 355, 391-97 (Tex. App.—Houston [1st Dist.] 2012, pet. granted) (case settled while petition pending) (Court declined to recognize a fiduciary duty of a majority member to a minority member generally since Texas does not recognize such a relationship between majority and minority shareholders in closely held corporations, but concluded that the majority member's position as the controlling member and sole manager was sufficient to create a fiduciary duty to the minority member in a transaction in which the minority member's interest was being redeemed; the Court also concluded that an exculpation provision in the LLC's articles of organization referring to the manager's "duty of loyalty to [the LLC] or its members" could be read to create a fiduciary duty to the members individually which would include a duty of candor to disclose material facts relating to the value of the interest to be redeemed); *Suntech Processing Sys., L.L.C. v. Sun Communications, Inc.*, 2000 WL 1780236, at *6-7 (Tex. App.—Dallas Dec. 5, 2000, pet. denied) (not designated for publication) (minority Member of a Texas LLC claimed that the controlling Member owed a fiduciary duty as a matter of law in connection with the winding up of operations and distribution of assets; the Court pointed out that the Regulations expressly provided for a duty of loyalty to the LLC rather than between the Members, and, noting the absence of Texas case law on fiduciary duties of LLC Members and looking to case law regarding fiduciary duties of shareholders of a closely held corporation, held that there was no fiduciary relationship between the Members as a matter of law). *See* Elizabeth S. Miller, *Practical Pitfalls in Drafting Texas Limited Liability Company Agreements*, 45:1 TEX. J. BUS. L. 27, 46 (2012).

47 *See* LLC Act § 2.20B; TBOC §§ 7.001, 101.052, 101.054 and101.401. Prior to the effectiveness of 1997 S.B. 555 on September 1, 1997, LLC Act § 8.12 had incorporated by reference the limitation of liability afforded to corporate directors under TMCLA 1302-7.06 and thereby allowed the limitation of Manager liability by a provision in the Articles (now, the Certificate of Formation) to the extent permitted for a director under TMCLA 1302-7.06. 1997 S.B. 555 deleted such incorporation by reference of TMCLA 1302-7.06 in favor of the broader authorization now in LLC Act § 2.20B, but a comparable provision was added back in TBOC § 7.001 as amended in 2013 by S.B. 847 § 2 as quoted *supra* in note 43.

48 DEL. CODE ANN. tit. 6, §§ 18-1101(a)-(f) (2013).

49 In Texas a common-law duty of good faith and fair dealing does not exist in all contractual relationships. *Blackmon-Dunda v. Mary Kay, Inc.*, 2009 WL 866214 (Tex. App.—Dallas April 1, 2009, pet. denied). Rather, the duty arises only when a contract creates or governs a special relationship between the parties. *Subaru of Am. v. David McDavid Nissan*, 84 S.W.3d 212, 225 (Tex. 2002). A "special relationship" has been recognized where there is unequal bargaining power between the parties and a risk exists that one of the parties may take advantage of the other based upon the imbalance of power, e.g., insurer-insured (*see Arnold v. Nat'l County Mut. Fire Ins. Co.*, 725 S.W.2d 165, 167 (Tex. 1987). The elements which make a relationship special are absent in the relationship between an employer and an employee. *See City of Midland v. O'Bryant*, 18 S.W.3d 209, 215 (Tex. 2000). While there are no reported Texas cases as to whether a contractual duty of good faith and fair dealing exists between Members in an LLC, or between Managers and Members in a Texas LLC, it is likely that the duty of good faith and fair dealing exists in those LLC

duties, and allows the elimination of liability for breach of fiduciary duties (other than the duty of loyalty).

The contractual expansion, modification, restriction or waiver of fiduciary duties is an important developing issue in the context of fiduciary duties for Texas LLCs. The Texas Legislature in 2013 amended TBOC § 7.001(d)(3) to expand the permitted contractual limitation or elimination of liabilities for monetary damages for breach of fiduciary duties by Members and Managers of Texas LLCs, but does not allow the elimination of liabilities for breaches of the duty of loyalty or acts or omissions not in good faith.[50]

In a joint venture, the duty of a Manager to the LLC or all Members could be an issue since the Managers would often have been selected to represent the interests of particular Members. The issue could be addressed by structuring the LLC to be managed by Members who would then appoint representatives to act for them on an operating committee which would run the business in the name of the Members. In such a situation, the Members would likely have

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relationships, just as fiduciary duties likely exist, except in each case to the extent that the duty has been restricted by contract as permitted by the Tex. LLC Stats. *See* Business Entities Paper notes 87-89 and 792.

[50] A Company Agreement provision restricting or waiving fiduciary duties and limiting liability for breaches thereof as permitted by TBOC §§ 7.001, 101.052, 101.054 and 101.401 could read as follows:

> This Agreement is not intended to, and does not, create or impose any fiduciary duty on any Member or Manager. Furthermore, each of the Members, the Managers and the Company hereby, to the fullest extent permitted by Applicable Law [defined to mean the TBOC and other applicable Texas and federal statutes and regulations thereunder], restricts, limits, waives and eliminates any and all duties, including fiduciary duties, that otherwise may be implied by Applicable Law and, in doing so, acknowledges and agrees that the duties and obligations of each Member or Manager to each other and to the Company are only as expressly set forth in this Agreement and that no Member or Manager shall have any liability to the Company or any other Member or Manager for any act or omission except as specifically provided by Applicable Law or in this Agreement or another written agreement to which the Member or Manager is a party. The provisions of this Agreement, to the extent that they restrict, limit, waive and eliminate the duties and liabilities of a Member or Manager otherwise existing at law or in equity, are agreed by the Members to replace such other duties and liabilities of such Members or Managers.
>
> Notwithstanding anything to the contrary contained in this Agreement,
>
> (1) the Managers shall not permit or cause the Company to engage in, take or cause any of the following actions except with the prior approval of a majority of the outstanding Units voting: [*list specific actions*]:
>
> (2) the Members and Managers and each of their respective Affiliates are permitted to have, and may presently or in the future have, investments or other business relationships, ventures, agreements or arrangements (i) with entities engaged in the business of the Company, other than through the Company (an "Other Business") and (ii) with [*additional entity specifics*]; [*provided*, that any transactions between the Company and an Other Business will be on terms no less favorable to the Company than would be obtainable in a comparable arm's-length transaction]; and
>
> (3) there shall be a presumption by the Company that any actions taken in good faith by the Manager on behalf of the Company shall not violate any fiduciary or other duties owed by the Managers to the Company or the Members.

Provisions such as the foregoing are often subject to intense negotiations.

fiduciary duties analogous to partners in a general partnership.[51] Alternatively, the Company Agreement could restrict a Manager's fiduciary duties so that they are owed only to specified Members.[52]

(b) Delaware. The DLLCA does not codify Manager or Member fiduciary duties, but expressly permits the modification or elimination of fiduciary duties in an LLC,[53] although not all Delaware LLC Agreements effectively do so.[54] Provisions to the effect that a Manager may enter into a self-dealing transaction (such as its purchase of the LLC's assets) only if it proved that the terms were fair can have the effect of contractually incorporating a core element

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51 *Id.*; *see* TRPA § 4.04; *see also* TBOC § 152.204.

52 *See supra* note 43.

53 *See* note 27 *supra*; *see* Business Entities Paper 364-380.

54 *In re Atlas Energy Resources LLC*, Consolidated 2010 WL 4273122 (Del Ch. Oct. 28, 2010), involved breach of fiduciary duty claims arising from a merger between a publicly traded LLC and its controlling unitholder. In *In re Atlas*, the Chancery Court held that an LLC agreement eliminated the traditional fiduciary duties of the LLC's directors and officers, replacing them with a contractually-defined duty of good faith, which was not breached, but did not address the duties of the controlling unitholder, which were held to be equivalent to those of a controlling shareholder of a Delaware corporation. The Court commented that LLCs are creatures of contract designed to afford the maximum amount of freedom of contract, private ordering, and flexibility to the parties involved. One aspect of this flexibility, the Court wrote, is that parties to an LLC agreement can contractually expand, restrict, modify or fully eliminate the fiduciary duties owed by its members, subject to certain limitations, but in the absence of explicit provisions in the LLC agreement to the contrary, the traditional fiduciary duties owed by corporate directors and controlling shareholders apply in the LLC context. Because this LLC agreement did not eliminate the fiduciary duties of the controlling unitholder, it owed directly to the LLC's minority unitholders the traditional fiduciary duties that controlling shareholders owe minority shareholders. Since the merger created a conflict between the controlling unitholder's interest in acquiring the balance of the LLC for the lowest possible price and the minority unitholders' interest in obtaining a high price for their units and the LLC agreement did not address this conflict of interest, the Court evaluated the merger under the entire fairness standard of review in order to assure that the controlling unitholder "has been assiduous in fulfilling those duties," held that "plaintiffs' allegations as to price and process, adequately suggest that the merger was not entirely fair to the public unitholders," and denied defendants' motion to dismiss the claim for breach of fiduciary duty by the controlling unitholder.

The court in *In re Heritage Org., LLC*, 2008 WL 5215688 (Bankr. N.D. Tex. Dec. 12, 2008) followed DLLCA § 18-1101(e). The case involved a bankruptcy trustee's breach of fiduciary duty claims against former officers of a bankrupt Delaware LLC which had an LLC agreement that eliminated fiduciary duties in the following sweeping language:

> The Manager shall not be required to exercise any particular standard of care, nor shall he owe any fiduciary duties to the Company or the other Members. Such excluded duties include, by way of example, not limitation, any duty of care, duty of loyalty, duty of reasonableness, duty to exercise proper business judgment, duty to make business opportunities available to the company, and any other duty which is typically imposed upon corporate officers and directors, general partners or trustees. The Manager shall not be held personally liable for any harm to the Company or the other Members resulting from any acts or omissions attributed to him. Such acts or omissions may include, by way of example but not limitation, any act of negligence, gross negligence, recklessness, or intentional misconduct.

Faced with this broad clause, the bankruptcy court in *Heritage* held that the defendants had no fiduciary duties to breach, and thus rejected the trustee's breach of fiduciary duty claim. *Cf. Kahn v. Portnoy*, 2008 WL 5197164 (Del. Ch. December 11, 2008) (under freedom of contract principles, fiduciary duties held to be defined, but not eliminated, by LLC agreement).

of the traditional common law fiduciary duty of loyalty into an LLC Agreement.[55] The DLLCA has been amended, effective August 1, 2013, to provide that unless modified in an LLC's governing documents, common law fiduciary duties apply to LLCs.[56]

The DLLCA aggressively adopts a "contractarian approach" (i.e., the bargains of the parties manifested in LLC Agreements are to be respected and rarely trumped by statute or common law).[57] The DLLCA does not have any provision which itself creates or negates Member

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55 *See Auriga Capital Corp. v. Gatz Properties, LLC*, 40 A.3d 839, 844-51 (Del. Ch. 2012), *aff'd*, 59 A.3d 1206 (Del. 2012), in which the LLC Agreement provided that, without the consent of the holders of two-thirds of the interests not held by the Manager or its affiliates, the Manager would not be entitled to cause the LLC to enter into any transaction with an affiliate that is less favorable to the LLC than that which could be entered into with an unaffiliated third party. The LLC Agreement's exculpation provision provided that the Manager would not be liable to the LLC for actions taken or omitted by the Manager in good faith and without gross negligence or willful misconduct. As the LLC Agreement's exculpatory provision expressly did not excuse bad faith action, willful misconduct, or even grossly negligent action, by the LLC Manager, the Manager was liable for the losses caused by its flawed merger. Delaware Chancellor Strine, mused that under traditional principles of equity applicable to an LLC and in the absence of a contrary LLC agreement provision, a Manager of an LLC would owe to the LLC and its members the common law fiduciary duties of care and loyalty.

The Delaware Supreme Court affirmed *Auriga* in *Gatz Properties, LLC v. Auriga Capital Corp.*, 59 A.3d 1206, 1213 (Del. 2012), *aff'g* 40 A.3d 839, holding that although the LLC agreement did not use words such as "entire fairness" or "fiduciary duties," there was nonetheless an explicit contractual assumption by the parties of an obligation on the part of the Manager and Members of the LLC to obtain a fair price for the LLC in transactions between the LLC and affiliates, but the Supreme Court expressly rejected the Chancellor's conclusion that common law fiduciary duties exist by "default" in an LLC in the absence of a provision in the LLC's governing documents expressly creating, restricting or eliminating them.

56 DLLCA § 18-1104 has been amended, effective August 1, 2013, to effectively overturn the part of the Supreme Court's decision in *Gatz* (*supra* note 55) that fiduciary duties do not exist in an LLC unless its governing documents create them and now provides as follows: "In any case not provided for in this chapter, the rules of law and equity, including the rules of law and equity relating to fiduciary duties and the law merchant, shall govern." [new language underlined]. The synopsis accompanying the amendment in Delaware H.B. 126 explains it as follows:

> Section 8 amends Section 18-1104 to confirm that in some circumstances fiduciary duties not explicitly provided for in the limited liability company agreement apply. For example, a manager of a manager-managed limited liability company would ordinarily have fiduciary duties even in the absence of a provision in the limited liability company agreement establishing such duties. Section 18-1101(c) continues to provide that such duties may be expanded, restricted or eliminated by the limited liability company agreement.

57 In *Fisk Ventures, LLC v. Segal*, 2008 WL 1961156 (Del. Ch. 2008), *judgment aff'd* 984 A.2d 124 (Del. 2009), Delaware Chancellor William Chandler wrote that LLCs are creatures of contract and that a prerequisite to any breach of contract analysis is to determine if there is a *duty* in the document that has been breached. The Chancellor quoted in footnote 34 Chief Justice Steele's article entitled *Judicial Scrutiny of Fiduciary Duties in Delaware Limited Partnerships and Limited Liability Companies*, 32 Del. J. Corp. L. 1, 4 (2007) ("Courts should recognize the parties' freedom of choice exercised by contract and should not superimpose an overlay of common law fiduciary duties…"), and found no provision in the LLC Agreement at issue that: "create[d] a code of conduct for all members; on the contrary, most of those sections expressly claim to limit or waive liability." The Chancellor wrote:

> There is no basis in the language of the LLC Agreement for Segal's contention that all members were bound by a code of conduct, but, even if there were, this Court could not enforce such a code because there is no limit whatsoever to its applicability".

In addressing the breach of fiduciary duty claims asserted by plaintiff, the Chancellor focused on DLLCA § 18-1101(c) which allows for the complete elimination of all fiduciary duties in an LLC agreement. The Court then read the subject LLC Agreement to eliminate fiduciary duties because it flatly stated that:

> No Member shall have any duty to any Member of the Company except as expressly set forth herein or in other written agreements. No Member, Representative, or Officer of the Company shall be liable to the Company or to any Member for any loss or damage sustained by the Company or to any Member, unless the loss or damage shall have been the result of gross negligence, fraud or intentional misconduct by the Member, Representative, or Officer in question….

Because the foregoing LLC Agreement exception for gross negligence, fraud or intentional misconduct did not create a fiduciary duty and the LLC Agreement did not otherwise expressly articulate fiduciary obligations, the foregoing LLC Agreement provision was held to be sufficient to eliminate defendant's fiduciary duties.

The Chancellor considered and disposed of plaintiff's "implied covenant of good faith and fair dealing" claim as follows:

> Every contract contains an implied covenant of good faith and fair dealing that "requires a 'party in a contractual relationship to refrain from arbitrary or unreasonable conduct which has the effect of preventing the other party to the contract from receiving the fruits' of the bargain." Although occasionally described in broad terms, the implied covenant is not a panacea for the disgruntled litigant. In fact, it is clear that "a court cannot and should not use the implied covenant of good faith and fair dealing to fill a gap in a contract with an implied term unless it is clear from the contract that the parties would have agreed to that term had they thought to negotiate the matter." Only rarely invoked successfully, the implied covenant of good faith and fair dealing protects the spirit of what was *actually bargained and negotiated for* in the contract. Moreover, because the implied covenant is, by definition, *implied*, and because it protects the *spirit* of the agreement rather than the form, it cannot be invoked where the contract itself expressly covers the subject at issue.
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> Here, Segal argues that Fisk, Rose and Freund breached the implied covenant of good faith and fair dealing by frustrating or blocking the financing opportunities proposed by Segal. However, neither the LLC Agreement nor any other contract endowed him with the right to unilaterally decide what fundraising or financing opportunities the Company should pursue, and his argument is "another in a long line of cases in which a plaintiff has tried, unsuccessfully, to argue that the implied covenant grants [him] a substantive right that [he] did not extract during negotiation." Moreover, the LLC Agreement *does* address the subject of financing, and its specifically requires the approval of 75% of the Board. Implicit in such a requirement is the right of the Class B Board representatives to disapprove of and therefore block Segal's proposals. As this Court has previously noted, "[t]he mere exercise of one's contractual rights, without more, cannot constitute … a breach [of the implied covenant of good faith and fair dealing]." Negotiating forcefully and within the bounds of rights granted by the LLC agreement does not translate to a breach of the implied covenant on the part of the Class B members.

In *Related Westpac LLC v. JER Snowmass LLC*, 2010 WL 2929708 (Del. Ch. July 23, 2010), the Delaware Chancery Court held that one Member of an LLC could not force another to advance funds in a joint redevelopment project and consent to related projects, finding that the partner's refusal was permitted by the project's operating agreements. In so deciding, the Court refused to find that a condition of reasonableness to the right to refuse consent:

> In this decision, I dismiss the complaint. Under the operating agreements that govern the LLCs, the defendant member could not unreasonably withhold its consent to certain decisions. But as to the type of decisions at issue in this case — so-called "material actions" — the defendant member was not subject to such a constraint and had contractually bargained to remain free to give or deny its consent if that was in its own commercial self-interest. Here, the plaintiff operating member seeks to have the court impose a contractual reasonableness overlay on a contract that is clearly inconsistent with

or Manager fiduciary duties, but instead allows modification or elimination of fiduciary duties[58] by an LLC agreement.[59] While the DLLCA allows the complete elimination of common law fiduciary duties in an LLC Agreement,[60] it does not allow the elimination of "the implied

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> the parties' bargain. Delaware law respects contractual freedom and requires parties like the operating member to adhere to the contracts they freely enter. The operating agreements here preclude the relief the operating member seeks, including its attempt to end-run the operating agreements by arguing that the defendant member had a fiduciary duty to act reasonably in granting consent. Under the plain terms of the operating agreements, the defendant member had bargained for the right to give consents to decisions involving material actions or not, as its own commercial interests dictated. Having bargained for that freedom and gained that concession from the operating member, the defendant member is entitled to the benefit of its bargain and the operating member cannot attempt to have the court write in a reasonableness condition that the operating member gave up. The words "not unreasonably withheld" are well known and appear in other sections of the operating agreements. They do not qualify the defendant member's right to deny consent to major decisions involving a material action.
>
> Likewise, the operating agreements clearly state the sole remedy the operating member has if the defendant member fails to meet a capital call. The operating member again seeks to have this court impose a remedy inconsistent with the plain terms of the operating agreements. This court cannot play such a role, and the operating member's claims relating to the capital call are dismissed because they are inconsistent with the operating agreements.

58 *See supra* note 27.

59 *See* Myron T. Steele, *Judicial Scrutiny of Fiduciary Duties in Delaware Limited Partnerships and Limited Liability Companies*, 32 DEL. J. CORP. L. 1, 25 (2007), in which Delaware Supreme Court Chief Justice Steele argues that parties forming limited liability companies should be free to adopt or reject some or all of the fiduciary duties recognized at common law, that courts should look to the parties' agreement and apply a contractual analysis, rather than analogizing to traditional notions of corporate governance, in LLC fiduciary duty cases, and that:

> Delaware's Limited Liability Company Act does not specify the duties owed by a member or manager. It does, however, like the Limited Partnership Act, provide for a default position "to the extent, at law or in equity" limited liability companies have "duties (including fiduciary duties)." These duties, in turn, "may be expanded or restricted or eliminated" in the agreement, provided that the "agreement may not eliminate the implied contractual covenant of good faith and fair dealing."
>
> The same issues and considerations that arise in limited partnerships arise in governance disputes in limited liability companies. There is an assumed default to traditional corporate governance fiduciary duties where the agreement is silent, or at least not inconsistent with the common law fiduciary duties. Lack of clarity in the agreements on this point may confuse the court and cause it to focus improperly when addressing the conduct complained of in a derivative action or in an action to interpret, apply, or enforce the terms of the limited liability company agreement. Predictably, but not necessarily correctly, Delaware courts will gravitate toward a focus on the parties' status relationship and not their contractual relationship in the search for a legal and equitable resolution of a dispute unless the agreement explicitly compels the court to look to its terms and not to the common law fiduciary gloss.

60 A Limited Liability Company Agreement provision eliminating fiduciary duties as permitted by the DLLCA could read as follows:

> Except as expressly set forth in this Agreement or expressly required by the Delaware Act, no Manager or Member shall have any duties or liabilities, including fiduciary duties, to the Company or any Member, and the provisions of this Agreement, to the extent that they restrict, eliminate or otherwise modify the duties and liabilities, including fiduciary duties,

contractual covenant of good faith and fair dealing."[61] Provisions limiting or eliminating fiduciary duties are often subject to intense negotiations and some investors may not agree to the limitations

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of any Manager or Member otherwise existing at law or in equity, are agreed by the Company and the Members to replace such other duties and liabilities of the Managers and Members; provided that nothing here shall be construed to eliminate the implied contractual covenant of good faith and fair dealing under Delaware law.

[61] *Id. See* RESTATEMENT (SECOND) OF CONTRACTS and related Comment which provide:

§ 205. Duty of Good Faith and Fair Dealing

Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.

Comment:

a. Meanings of "good faith." Good faith is defined in Uniform Commercial Code § 1-201(19) as "honesty in fact in the conduct or transaction concerned." "In the case of a merchant," Uniform Commercial Code § 2-103(1)(b) provides that good faith means "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." The phrase "good faith" is used in a variety of contexts, and its meaning varies somewhat with the context. Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterized as involving "bad faith" because they violate community standards of decency, fairness or reasonableness. The appropriate remedy for a breach of the duty of good faith also varies with the circumstances.

b. Good faith purchase. In many situations a good faith purchaser of property for value can acquire better rights in the property than his transferor had. See, e.g., § 342. In this context "good faith" focuses on the honesty of the purchaser, as distinguished from his care or negligence. Particularly in the law of negotiable instruments inquiry may be limited to "good faith" under what has been called "the rule of the pure heart and the empty head." When diligence or inquiry is a condition of the purchaser's right, it is said that good faith is not enough. This focus on honesty is appropriate to cases of good faith purchase; it is less so in cases of good faith performance.

c. Good faith in negotiation. This Section, like Uniform Commercial Code § 1-203, does not deal with good faith in the formation of a contract. Bad faith in negotiation, although not within the scope of this Section, may be subject to sanctions. Particular forms of bad faith in bargaining are the subjects of rules as to capacity to contract, mutual assent and consideration and of rules as to invalidating causes such as fraud and duress. See, for example, §§ 90 and 208. Moreover, remedies for bad faith in the absence of agreement are found in the law of torts or restitution. For examples of a statutory duty to bargain in good faith, see, e.g., National Labor Relations Act § 8(d) and the federal Truth in Lending Act. In cases of negotiation for modification of an existing contractual relationship, the rule stated in this Section may overlap with more specific rules requiring negotiation in good faith. See §§ 73, 89; Uniform Commercial Code § 2-209 and Comment.

d. Good faith performance. Subterfuges and evasions violate the obligation of good faith in performance even though the actor believes his conduct to be justified. But the obligation goes further: bad faith may be overt or may consist of inaction, and fair dealing may require more than honesty. A complete catalogue of types of bad faith is impossible, but the following types are among those which have been recognized in judicial decisions: evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of a power to specify terms, and interference with or failure to cooperate in the other party's performance.

on duties and liabilities that those in control propose. In some LLC Agreements, fiduciary duties are eliminated so that a contractual arrangement can be substituted for dealing with the handling of business opportunities.[62] Provisions in LLC Agreements purporting to limit fiduciary duties need to be explicit and conspicuous as LLC coyness can lead to unenforceability.[63]

> *e. Good faith in enforcement.* The obligation of food faith and fair dealing extends to the assertion, settlement and litigation of contract claims and defenses. See, e.g., §§ 73, 89. The obligation is violated by dishonest conduct such as conjuring up a pretended dispute, asserting an interpretation contrary to one's own understanding, or falsification of facts. It also extends to dealing which is candid but unfair, such as taking advantage of the necessitous circumstances of the other party to extort a modification of a contract for the sale of goods without legitimate commercial reason. See Uniform Commercial Code § 2-209, Comment 2. Other types of violation have been recognized in judicial decisions: harassing demands for assurances of performance, rejection of performance for unstated reasons, willful failure to mitigate damages, and abuse of a power to determine compliance or to terminate the contract. For a statutory duty of good faith in termination, see the federal Automobile Dealer's Day in Court Act, 15 U.S.C. §§ 1221-25 (1976).
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> In *Kuroda v. SPJS Holdings, L.L.C.*, 971 A.2d 872, 888 (Del. Ch. April 15, 2009), a dispute among members of an LLC, the Chancellor dismissed plaintiff's allegations that the defendant members had breached the implied covenant of good faith and fair dealing by failing to pay him monies due, disparagements and threats because plaintiff had "failed to articulate a contractual benefit he was denied as a result of defendants' breach of an implied provision in the contract," and explained:
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> > The implied covenant of good faith and fair dealing inheres in every contract and "requires 'a party in a contractual relationship to refrain from arbitrary or unreasonable conduct which has the effect of preventing the other party to the contract from receiving the fruits' of the bargain." The implied covenant cannot be invoked to override the express terms of the contract. Moreover, rather than constituting a free floating duty imposed on a contracting party, the implied covenant can only be used conservatively "to ensure the parties' 'reasonable expectations' are fulfilled." Thus, to state a claim for breach of the implied covenant, Kuroda "must allege a specific implied contractual obligation, a breach of that obligation by the defendant, and resulting damage to the plaintiff." General allegations of bad faith conduct are not sufficient. Rather, the plaintiff must allege a specific implied contractual obligation and allege how the violation of that obligation denied the plaintiff the fruits of the contract. Consistent with its narrow purpose, the implied covenant is only rarely invoked successfully.
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> This contractual duty of good faith and fair dealing is to be contrasted with the fiduciary duty of good faith, which is a component of the common law fiduciary duty of loyalty. *See Stone v. Ritter*, 911 A.2d 362 (Del. 2006). DLLCA §§ 18-1101(a)-(f) are counterparts of, and virtually identical to, §§ 17-1101(a)-(f) of the Delaware Revised Limited Partnership Act. *See* DEL. CODE ANN. tit. 6, § 17-1101 (2009). Thus, Delaware cases regarding contractual limitation of partner fiduciary duties should be helpful in the LLC context.
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> *See* Business Entities Paper notes 1542-1543 and related text.

[62] Leo E. Strine, Jr. and J. Travis Laster, *The Siren Song of Unlimited Contractual Freedom*, Harvard Law School John M. Olin Center Discussion Paper No. 789, pg. 8, http://www.law.harvard.edu/programs/olin_center/papers/pdf/Strine_789.pdf (last visited April 6, 2020).

[63] *Solar Cells, Inc. v. True N. Partners, LLC*, No. CIV.A.19477, 2002 WL 749163, at *4 (Del. Ch. Apr. 25, 2002). In *Solar Cells*, Chancellor Chandler enjoined the merger of an LLC with an affiliate of the controlling

owner on the basis of the Delaware "entire fairness" doctrine notwithstanding an operating agreement section providing in relevant part as follows:

> Solar Cells and [First Solar] acknowledge that the True North Managers have fiduciary obligations to both [First Solar] and to True North, which fiduciary obligations may, because of the ability of the True North Managers to control [First Solar] and its business, create a conflict of interest or a potential conflict of interest for the True North Managers. Both [First Solar] and Solar Cells hereby waive any such conflict of interest or potential conflict of interest and agree that neither True North nor any True North Manager shall have any liability to [First Solar] or to Solar Cells with respect to any such conflict of interest or potential conflict of interest, provided that the True North managers have acted in a manner which they believe in good faith to be in the best interest of [First Solar].

Chancellor Chandler noted that the above clause purports to limit liability stemming from any conflict of interest, but that Solar Cells had not requested that the Court impose liability on the individual defendants; rather it was only seeking to enjoin the proposed merger. Therefore, exculpation for personal liability would have no bearing on whether the proposed merger was inequitable and should be enjoined. Further, Chancellor Chandler wrote that "even if waiver of liability for engaging in conflicting interest transactions is contracted for, that does not mean that there is a waiver of all fiduciary duties [for the above quoted provision] expressly states that the True North Managers must act in 'good faith.'"

Noting that the LLC was in financial distress and that the owners had been negotiating unsuccessfully to develop a mutually acceptable recapitalization, the Chancellor found that the managers appointed by the controlling owners appeared not to have acted in good faith when they had adopted the challenged plan of merger by written consent without notice to the minority managers. Chancellor Chandler commented:

> The fact that the Operating Agreement permits action by written consent of a majority of the Managers and permits interested transactions free from personal liability does not give a fiduciary free reign to approve any transaction he sees fit regardless of the impact on those to whom he owes a fiduciary duty.

Persons who control Members can be held responsible for fiduciary duty breaches of the Members.[64] A legal claim exists in some jurisdictions for aiding and abetting a breach of fiduciary duty, whether arising under statute, contract, common law or otherwise.[65]

In these multimember LLC joint venture structures, there are a number of factors to consider in the fiduciary duty context, including the duration of any duties, Manager and non-Manager duties, duties amongst the LLC's Members, and the process for handling potential conflicts of interest. How to handle "business opportunities" that come to one of the venturers that

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64 In *Bay Center Apartments Owner, LLC v. Emery Bay PKI, LLC*, 2009 WL 1124451 (Del. Ch. April 20, 2009), Delaware Vice Chancellor Strine wrote that "in the absence of a contrary provision in the LLC agreement, the manager of an LLC owes the traditional fiduciary duties of loyalty and care to the members of the LLC," and held that LLC agreement provisions that "Members shall have the same duties and obligations to each other that members of a limited liability company formed under the Delaware Act have to each other" and "except for any duties imposed by this Agreement . . . each Member shall owe no duty of any kind towards the Company or the other Members in performing its duties and exercising its rights hereunder or otherwise" had the effect of leaving in place the traditional Delaware common law fiduciary duties. The Vice Chancellor then summarized those duties as follows in footnote 33:

> The Delaware LLC Act is silent on what fiduciary duties members of an LLC owe each other, leaving the matter to be developed by the common law. The LLC cases have generally, in the absence of provisions in the LLC agreement explicitly disclaiming the applicability of default principles of fiduciary duty, treated LLC members as owing each other the traditional fiduciary duties that directors owe a corporation. Moreover, when addressing an LLC case and lacking authority interpreting the LLC Act, this court often looks for help by analogy to the law of limited partnerships. In the limited partnership context, it has been established that "[a]bsent a contrary provision in the partnership agreement, the general partner of a Delaware limited partnership owes the traditional fiduciary duties of loyalty and care to the Partnership and its partners." (Citations omitted)

The court then held the owner and manager of the LLC personally liable for the fiduciary duty breaches of the LLC's managing member.

Cf. In re USACafes, L.P. Litigation, 600 A.2d 43, 48 (Del. Ch. 1991); *Carson v. Lynch Multimedia Corp.*, 123 F. Supp. 2d 1254, 1264 (D. Kan. 2000).

65 *Fitzgerald v. Cantor*, No. CIV.A.16297-NC, 1999 WL 182573, at *1 (Del. Ch. Mar. 25, 1999) (holding that the elements of a claim for aiding and abetting a breach of fiduciary duty are: (1) the existence of a fiduciary relationship; (2) the fiduciary breached its duty; (3) a defendant, who is not a fiduciary, knowingly participated in a breach; and (4) damage to the plaintiff resulted from the concerted action of the fiduciary and the non-fiduciary).

arguably may "belong" to the joint venture is a common and difficult conflict of interest issue.[66] Guidance in dealing with such matters can be found in the laws of both Texas[67] and Delaware.[68]

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66 The "business opportunity doctrine," also called the "corporate opportunity doctrine," deals with when a fiduciary of an entity may take personal advantage of a "business opportunity" that arguably "belongs" to the entity. It arises out of the fiduciary duty of loyalty, which generally provides that a director or officer of an entity may not place his individual interests over the interests of the entity or its owners. Business opportunity claims often are instances in which officers or governing persons use for their personal advantage information obtained in their entity capacity, and arise where the fiduciary and the entity compete against each other to buy something, whether it be a patent, license, or an entire business. *Thorpe v. CERBCO, Inc.*, 676 A.2d 436 (Del. 1996). The central question is whether or not the governing person has appropriated something for himself that, in all fairness, should belong to his entity. *Equity Corp. v. Milton*, 221 A.2d 494, 497 (Del. 1966).

67 *Landon v. S & H Marketing Group, Inc.*, 82 S.W.3d 666, 672 (Tex. App.—Eastland 2002, no pet.), summarizes the Texas law on usurpation of business opportunities as follows:

> To establish a breach of fiduciary duty by usurping a corporate opportunity, the corporation must prove that an officer or director misappropriated a business opportunity that properly belongs to the corporation. *International Bankers Life Insurance Company v. Holloway*, supra at 576-78; Icom Systems, Inc. v. Davies, 990 S.W.2d 408, 410 (Tex. App.—Texarkana 1999, no writ). The business opportunity arises where a corporation has a legitimate interest or expectancy in and the financial resources to take advantage of a particular business opportunity. * * * A corporation's financial inability to take advantage of a corporate opportunity is one of the defenses which may be asserted in a suit involving an alleged appropriation of a corporate opportunity. * * * A corporation's abandonment of a business opportunity is another defense to a suit alleging usurpation of a corporate opportunity. * * * The burden of pleading and proving corporate abandonment and corporate inability is placed upon the officer or director who allegedly appropriated the corporate opportunity. * * *

Texas recognizes that a fiduciary may independently generate an opportunity in which his principal has no ownership expectations. (*Scruggs Management Appellant Services, Inc. v. Hanson*, 2006 WL 3438243, at *1 (Tex. App.—Fort Worth, Nov. 30, 2006, pet. denied)). The fiduciary duty of candor, however, may not allow a governing person to unilaterally determine that a business opportunity would not be pursued by his entity and may require that the opportunity be presented formally to the entity's governing authority for its determination. *Imperial Group (Texas), Inc. v. Scholnick*, 709 S.W.2d 358, 363 (Tex. App.—Tyler 1986, writ ref'd n.r.e.; *Icom Systems, Inc. v. Davies*, 990 S.W.2d 408, 410 (Tex. App.—Texarkana 1999, no pet.). The burden of pleading and proving that the entity was unable to take advantage of the opportunity is on the governing person or officer who allegedly appropriated the opportunity. *Landon v. S & H Marketing Group, Inc.*, 82 S.W.3d 666, 673 (Tex. App.—Eastland 2002, no pet.). However, a finding that the entity would not have exercised the opportunity at issue under the same terms and conditions as the officer or governing person is immaterial. A fiduciary cannot escape the duty to disclose an opportunity presented by securing an after-the-fact finding that the entity was unable to take advantage of or would have rejected the business opportunity seized by the fiduciary had it been offered. When an officer or governing person usurps a business opportunity, he has breached the fiduciary duty of loyalty.

TBOC § 2.101(21) permits an entity to renounce, in its certificate of formation or by action of its governing authority, any interest or expectancy of the entity in specified business opportunities, or a specified class thereof, presented to the entity or one or more of its officers, governing persons or owners. Since TBOC § 2.101(21) does not appear to authorize blanket renunciations of all business opportunities, a boilerplate renunciation may be less protective than one tailored to each situation. Further, although TBOC § 2.101(21) allows an entity to specifically forgo individual business opportunities or classes of opportunities, the level of judicial scrutiny applied to the decision to make any such renunciation of business opportunities will generally be governed by a traditional common law fiduciary duty analysis, which means that a governing authority decision to renounce business opportunities should be made by informed and disinterested directors.

In order to memorialize their desired level of fiduciary duty commitments, parties to a multimember LLC could seek to avoid the uncertainty of default duties and clearly delineate each person's obligations to the LLC and each other.[69] For example, in the context of potential conflicts

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[68] Like its Texas counterpart, the business opportunity doctrine in Delaware prohibits an officer or director of an entity from diverting a business opportunity presented to, or otherwise rightfully belonging to, the entity to himself or any of his affiliates. In Delaware, the business opportunity doctrine dictates that an officer or director may not take a business opportunity for his own if: (1) the entity is financially able to exploit the opportunity; (2) the opportunity is within the entity's line of business; (3) the entity has an interest or expectancy in the opportunity; and (4) by taking the opportunity for his own the entity fiduciary will thereby be placed in a position inimical to his duties to the entity. *Guth v. Loft, Inc.*, 5 A.2d 503, 510-11 (Del. 1939), sets forth a widely quoted test for determining whether a director or officer wrongfully has diverted a business opportunity:

> if there is presented to a corporate officer or director a business opportunity which the corporation is financially able to undertake, is, from its nature, in the line of the corporation's business and is of practical advantage to it, is one in which the corporation has an interest or a reasonable expectancy, and, by embracing the opportunity, the self-interest of the officer or director will be brought into conflict with that of the corporation, the law will not permit him to seize the opportunity for himself.

Guth was explained and updated in 1996 by the Delaware Supreme Court in *Broz v. Cellular Info. Systems, Inc.*, 673 A.2d 148 (Del. 1996), as follows:

> The corporate opportunity doctrine, as delineated by *Guth* and its progeny, holds that a corporate officer or director may not take a business opportunity for his own if: (1) the corporation is financially able to exploit the opportunity; (2) the opportunity is within the corporation's line of business; (3) the corporation has an interest or expectancy in the opportunity; and (4) by taking the opportunity for his own, the corporate fiduciary will thereby be placed in a position inimicable to his duties to the corporation. The Court in *Guth* also derived a corollary which states that a director or officer *may* take a corporate opportunity if: (1) the opportunity is presented to the director or officer in his individual and not his corporate capacity; (2) the opportunity is not essential to the corporation; (3) the corporation holds no interest or expectancy in the opportunity; and (4) the director or officer has not wrongfully employed the resources of the corporation in pursuing or exploiting the opportunity. *Guth*, 5 A.2d at 509.
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> Thus, the contours of this doctrine are well established. It is important to note, however, that the tests enunciated in *Guth* and subsequent cases provide guidelines to be considered by a reviewing court in balancing the equities of an individual case. No one factor is dispositive and all factors must be taken into account insofar as they are applicable. * * *

Under Delaware law, even if the entity cannot establish its financial capability to have exploited the opportunity, the element will be met if the usurping party had a parallel contractual obligation to present business opportunities to the entity. The question of whether a director has usurped a business opportunity requires a fact-intensive analysis. Further, the defendant has the burden of proof to show that he did not usurp an opportunity that belonged to the entity.

Like Texas, Delaware law allows an entity to renounce any interest in business opportunities presented to the entity or one or more of its officers, directors or shareholders in its certificate of formation or by action of its governing authority. DGCL § 122(17). While this permits an entity to specifically forgo individual business opportunities or classes of opportunities, the type of judicial scrutiny applied to the decision to make any such renunciation of business opportunities will generally be governed by a traditional common law fiduciary duty analysis.

[69] Altman, Paul, Elisa Erlenbach Maas and Michael P. Maxwell, *Eliminating Fiduciary Duty Uncertainty: The Benefits of Effectively Modifying Fiduciary Duties in Delaware LLC Agreements*, Business Law Today, February 22, 2013, *available at* https://businesslawtoday.org/2013/02/eliminating-fiduciary-duty-

of interest, parties to a multimember LLC Agreement could seek to avoid the application of the corporate opportunity doctrine by including specific provisions on what the business of the LLC will likely be, what it will seek to accomplish, and what (if any) opportunities the Members and Managers will be able to pursue without having to present them to the LLC first (or at all).[70] Multimember LLCs could also seek to modify or eliminate fiduciary duties by contract in order to provide flexibility and certainty for Managers and Members making decisions in a management capacity for the LLC.

III. PRELIMINARY AGREEMENTS

A. Confidentiality Agreement

A confidentiality agreement, also sometimes called a non-disclosure agreement (***"NDA"***), is typically the first stage for the due diligence process as parties generally are reluctant to provide confidential information to the other side without having the protection of a confidentiality agreement.[71] The target typically proposes its form of confidentiality agreement, and a negotiation of the confidentiality agreement ensues.[72]

In *RAA Management, LLC v. Savage Sports Holdings, Inc.*,[73] the Delaware Supreme Court held that non-reliance disclaimer language in a confidentiality agreement was effective to bar fraud claims by a prospective buyer. The prospective buyer had been told by seller during early discussions that seller had no significant unrecorded liabilities, but due diligence showed otherwise. The confidentiality agreement provided that seller made no representations regarding

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uncertainty-the-benefits-of-effectively-modifying-fiduciary-duties-in-delaware-llc-agreements/ (last visited April 6, 2020).

70 *Id.*

71 *See* Byron F. Egan, *Confidentiality Agreements: How to Draft Them and What They Restrict*, XXXIII Corp. Coun. Review 35 (2014). A seller's form of confidentiality agreement is attached as **Appendix B** to Byron F. Egan, *Acquisition Structure Decision Tree*, TexasBarCLE & Business Law Section of State Bar of Texas Choice and Acquisition of Entities in Texas Course, San Antonio, May 22, 2015 http://www.jw.com/wp-content/uploads/2016/05/2045.pdf. *See also* Article 12 of the ABA Model Asset Purchase Agreement (2001), and the Model Confidentiality Agreement accompanying the ABA Model Public Company Merger Agreement (2011).

72 Some confidentiality agreements contain covenants restricting activities of the buyer after receipt of confidential information. *See, e.g., Goodrich Capital, LLC and Windsor Sheffield & Co., Inc. v. Vector Capital Corporation*, 11 Civ. 9247 (JSR), 2012 U.S. Dist. Lexis 92242, at *2-3 (S.D.N.Y. June 26, 2012) (NDA prohibited use of confidential information solely to explore the contemplated business arrangement and not to minimize broker's role or avoid payment of its fees; a prospective bidder used information provided about other comparable companies to acquire one of the other companies; broker's lawsuit against that prospective bidder for breach of contract for misusing confidential information survived motion to dismiss); *In re Del Monte Foods Company Shareholders Litigation*, 25 A.3d 813 (Del. Ch. 2011) (NDA restricted bidders from entering into discussions or arrangements with other potential bidders; in temporarily enjoining stockholder vote on merger because target was unduly manipulated by its financial adviser, Delaware Vice Chancellor Laster faulted bidders' violation of the "no teaming" provision in the confidentiality agreement and the target's Board for allowing them to do so); *see* discussion of *Del Monte* case in Byron F. Egan, *How Recent Fiduciary Duty Cases Affect Advice to Directors and Officers of Delaware and Texas Corporations*, 278; 289-293; 297 (Feb. 13, 2015), https://www.jdsupra.com/post/fileServer.aspx?fName=9c484c35-9819-4abc-a80f-6be742015c24.pdf.

73 45 A.3d 107, 119 (Del. 2012).

any information provided and that buyer could only rely on express representations in a definitive acquisition agreement, which was never signed.[74] After deciding not to pursue a transaction, the buyer sued seller to recover its due diligence and other deal costs. In affirming the Superior Court's dismissal of the buyer's complaint, the Delaware Supreme Court wrote:

> Before parties execute an agreement of sale or merger, the potential acquirer engages in due diligence and there are usually extensive precontractual negotiations between the parties. The purpose of a confidentiality agreement is to promote and to facilitate such precontractual negotiations. Non-reliance clauses in a confidentiality agreement are intended to limit or eliminate liability for misrepresentations during the due diligence process. The breadth and scope of the non-reliance clauses in a confidentiality agreement are defined by the parties to such preliminary contracts themselves. In this case, RAA and Savage did that, clearly and unambiguously, in the NDA.
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> * * *
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> The efficient operation of capital markets is dependent upon the uniform interpretation and application of the same language in contracts or other documents. The non-reliance and waiver clauses in the NDA preclude the fraud claims asserted by RAA against Savage. Under New York and Delaware law, the reasonable commercial expectations of the parties, as set forth in the non-reliance disclaimer clauses in Paragraph 7 and the waiver provisions in Paragraph 8 of the NDA, must be enforced. Accordingly, the Superior Court properly granted Savage's motion to dismiss RAA's Complaint.

B. Exclusivity Agreement

At an early stage in the negotiations for the formation of a joint venture, one party may ask for the other party to agree to negotiate exclusively with it, arguing that it will have to spend considerable time and resources in investigating the venture and developing a deal proposal, and it wants assurance that its prospective partner will not make a deal with another party before a proposal can be developed and negotiated.[75] The exclusivity agreement is sometimes included in a letter of intent as a party may be reluctant to agree not to negotiate with anyone else until it has confidence the prospective venture is good enough to merit negotiation.

C. Letter of Intent

A letter of intent is often entered into between prospective joint venturers following the successful completion of the first phase of negotiations of the prospective venture. A letter of

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[74] With respect to the effectiveness of non-reliance clauses to eliminate extra contractual liabilities (including fraud in the inducement claims), *see* the Comment to Section 13.7 on pages 299-319 of Byron F. Egan, *Acquisition Structure Decision Tree*, TexasBarCLE & Business Law Section of State Bar of Texas Choice and Acquisition of Entities in Texas Course, San Antonio, May 22, 2015 http://www.jw.com/wp-content/uploads/2016/05/2045.pdf.

[75] Richard E. Climan et al., *Negotiating Acquisitions of Public Companies in Transactions Structured as Friendly Tender Offers*, 116 Penn St. L. Rev. 615, 650-656 (2012).

intent typically describes the key economic and procedural terms that form the basis for further negotiations. In most cases, the parties do not yet intend to be legally bound to consummate the transaction and expect that the letter of intent will be superseded by a definitive written joint venture agreement. Alternatively, parties may prefer a memorandum of understanding or a term sheet to reflect deal terms. Many lawyers prefer to bypass a letter of intent and proceed to the negotiation and execution of a definitive joint venture agreement.

Although the seller and the buyer will generally desire the substantive deal terms outlined in their letter of intent to be nonbinding expressions of their then current understanding of the shape of the prospective transaction, letters of intent frequently contain some provisions that the parties intend to be binding.[76]

Disputes often arise over whether the parties have formed, or committed themselves to form, a joint venture. Texas law embraces the principles of freedom of contract and allows parties to condition their obligations to be bound by a contract or form a partnership. These principles were confirmed by the Texas Supreme Court in *Energy Transfer Partners, L.P. v. Enterprise Products Partners, L.P.* [77] which involved a series of preliminary agreements that were entered into between Energy Transfer Partners, L.P. ("***ETP***"), a Dallas based Delaware master limited partnership ("***MLP***"), and Enterprise Product Partners, L.P. ("***Enterprise***"), a Houston based Delaware MLP. ETP and Enterprise entered into these preliminary agreements with a view to forming a joint venture to build and operate a large pipeline which they called the "Double E Pipeline" from Cushing, Oklahoma, which was receiving oil from the Dakotas and Canada, to the Gulf Coast of Texas, which had refineries.

Those preliminary agreements provided that the obligations of the parties were conditioned on the execution of a definitive joint venture agreement and approvals by their respective boards of directors. Although no definitive joint venture agreement had been signed, the parties proceeded to spend time and money on the project and, reminiscent of *Texaco v. Pennzoil*,[78] they communicated publicly that a joint venture had been formed and marketed the pipeline to potential customers.

The parties marketing efforts did not produce enough commitments to ship through the proposed new pipeline to meet their agreed minimum threshold. Enterprise terminated its participation in the project and shortly thereafter entered into agreements with Enbridge (US) Inc. ("***Enbridge***"), another large pipeline company, for an alternative crude oil pipeline from Cushing to the Texas Gulf Coast. Enterprise and Enbridge had begun discussions before Enterprise announced that it had terminated the project.

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[76] **Appendix C** to Byron F. Egan, *Acquisition Structure Decision Tree*, TexasBarCLE & Business Law Section of State Bar of Texas Choice and Acquisition of Entities in Texas Course, San Antonio, May 22, 2015, http://www.jw.com/wp-content/uploads/2016/05/2045.pdf, includes a form of letter of intent and a discussion of considerations relevant to the decision whether to use a letter of intent and what to include in one.

[77] 593 S.W. 732 (Tex. 2020). A copy of the full opinion is available at: https://www.txcourts.gov/media/1445666/170862.pdf.

[78] 729 S.W.2d 768, 784 (Tex. App.—Houston [1st Dist.] 1987, writ ref'd n.r.e.).

ETP sued Enterprise in state court in Dallas alleging this breached Enterprise's contractual obligations and fiduciary duties to ETP. Notwithstanding the express provisions in preliminary agreements that no party was bound unless and until definitive agreements were signed, ETP claimed, and the jury found, that the parties' ensuing conduct served to form a Texas law general partnership and that Enterprise breached its fiduciary duty of loyalty to ETP when it negotiated with and then entered into an agreement with Enbridge. The trial court awarded ETP judgment for $535 million. This decision was reversed by the Court of Appeals.[79] The Texas Supreme Court affirmed the decision of the Court of Appeals, summarizing in the first paragraph:

> "The issue in this case is whether Texas law permits parties to conclusively agree that, as between themselves, no partnership will exist unless certain conditions are satisfied. We hold that it does and that the parties here made such an agreement. Accordingly, we affirm the judgment of the court of appeals."

More about this saga follows.

The preliminary agreements between ETP and Enterprise provided that there would be no partnership or joint venture formed unless and until later definitive agreements were executed. The parties' confidentiality agreement (the "***Confidentiality Agreement***") provided that they were not bound to pursue any transaction until a definitive agreement was signed in the following provision:

> The Parties agree that **unless and until a definitive agreement** between the Parties with respect to the Potential Transaction **has been executed and delivered**, and then only to the extent of the specific terms of such definitive agreement, **no Party hereto will be under any legal obligation of any kind whatsoever with respect to any transaction by virtue of this Agreement or any written or oral expression with respect to such a transaction by any Party or their respective Representatives, except, in the case of this Agreement, for the matters specifically agreed to herein**. A Party shall be entitled to cease disclosure of Confidential Information hereunder and **any Party may depart from negotiations at any time for any reason or no reason without liability to any Party hereto.**

The parties also signed a letter agreement and term sheet (the "***Letter of Intent***") that provided as follows:

> Neither this letter nor the JV Term Sheet create any binding or enforceable obligations between the Parties and, except for the [ETP] Confidentiality Agreement . . . no binding or enforceable obligations shall exist between the Parties with respect to the Transaction unless and until the Parties have received their respective board approvals and definitive agreements memorializing the terms and

[79] *Enterprise Products Partners, L.P. v. Energy Transfer Partners, L.P.*, 529 S.W.3d 531 (Tex. App.—Dallas 2017).

> conditions of the Transaction have been negotiated, executed and delivered by both of the Parties.
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> * * *
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> **Unless and until** such definitive agreements are executed and delivered by both of the Parties, either [Enterprise] or ETP, **for any reason**, may depart from or **terminate the negotiations with respect to the Transaction at any time without any liability or obligation** to the other, whether arising in contract, tort, strict liability or otherwise.

ETP and Enterprise also signed a Letter Agreement Regarding Sharing of Engineering Costs for Proposed Cushing to Houston Pipeline (the "***Reimbursement Agreement***") that stated that the parties had not completed negotiations of the proposed transaction and that no party was bound until the definitive agreements were signed:

> [Enterprise and ETP] **are in the process of negotiating mutually agreeable definitive agreements** ("the Definitive Agreements") related to the construction and operation of a crude oil pipeline between Cushing, OK and Houston, TX ("The Project"). Although **the negotiation** of the Definitive Agreements **has not been completed**, the Parties desire to begin work to develop a detailed engineering design package for The Project (the "Work") prior to execution of the Definitive Agreements.
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> * * *
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> It is understood by each of the Parties that the execution of this Agreement is intended to create and does create legally binding obligations between Enterprise and ETP but only as set forth herein. The obligations of the Parties shall be several and not joint and no Party shall have the right, authority or power to bind the other Party to any agreement without its prior written consent (other than the authority to commit and/or expend funds under Section I of this Agreement). Each Party expressly agrees to indemnify and hold the other Party harmless from liability if it binds or attempts to bind the other Party to any other agreement without such prior written consent. **Nothing herein shall be deemed to create or constitute a joint venture, a partnership, a corporation, or any entity taxable as a corporation, partnership or otherwise.**

ETP and Enterprise formed an integrated project team of their engineers to pursue the pipeline, communicated publicly that a joint venture had been formed, and marketed the pipeline to potential customers. Marketing materials in some instances stated that the parties had already "formed a Joint Venture LLC," a "50/50 JV," which they called "Double E Crude Pipeline, LLC." These marketing efforts were conducted jointly to potential customers, who were told, along with the Federal Energy Regulatory Commission and the Texas Railroad Commission, that a joint venture – the Double E Pipeline LLC – "had been formed" by ETP and Enterprise.

As part of their joint efforts and to comply with a Federal Energy Regulatory Commission rule governing new interstate pipelines, ETP and Enterprise announced an ***"open season,"*** a window of time during which shippers could sign a "Transportation Services Agreement" ("***TSA***"). A TSA is a long-term (sometimes decades-long) commitment to ship a certain number barrels a day for a certain tariff rate. TSAs are vitally important to new pipeline projects in that pipeline builders usually insist on having a certain level of shipper commitment prior to beginning construction in order to insure the economic viability of the prospective pipeline.

At the end of the open season, Chesapeake Energy signed a TSA with "Double E Pipeline LLC" to ship thousands of barrels a day, making it an "anchor shipper." Despite this TSA, in August 2011, Enterprise unilaterally issued a press release, announcing the termination of the project due to lack of long-term commitments from potential shippers. A few weeks later, Enterprise and Enbridge Inc. announced they would jointly pursue a crude pipeline project from Cushing to the Gulf Coast.

ETP filed suit in the 298th District Court in Dallas claiming that the parties' ensuing conduct served to form a Texas general partnership and that Enterprise breached its fiduciary duty of loyalty to ETP. The evidence introduced during the four-week jury trial showed that Enterprise executives had been secretly meeting with Enbridge personnel during the Double E open season. Testimonial and documentary evidence also showed that Enterprise represented to Enbridge that if the Double E project did not obtain enough shipper commitments during the open season, Enterprise would terminate Double E and announce its project with Enbridge instead.

During these meetings, Enterprise disclosed information generated by the Double E joint efforts, including technical engineering data, the pipeline route, economic modeling and Double E prospective customer information. The evidence also showed that Enterprise represented to Enbridge that the Chesapeake commitment had been made only to Enterprise, not to ETP or the joint venture. Enterprise and Enbridge ultimately did build a pipeline from Cushing, Oklahoma to the Gulf along the same route as the proposed Double E Pipeline. The biggest shipper for this new pipeline was Chesapeake Energy. The Enterprise/Enbridge pipeline also ultimately signed TSAs with other prospective customers of the proposed Double E Pipeline.

After deliberating for less than two days, the jury found for ETP, notwithstanding the express provisions in the Confidentiality Agreement, the Letter of Intent and the Reimbursement Agreement that no party was bound unless and until definitive agreements were signed. Ignoring the conditions precedent expressed in the documents, the jury concluded that ETP and Enterprise had conducted themselves as partners and that Enterprise's conduct breached the duties it owed to ETP.

The jury charge on whether the parties' conduct resulted in a partnership was based on the five factor test set forth in § 152.052(a) of the Texas Business Organizations Code ("***TBOC***") for determining whether a partnership exists: (i) the right to share profits, (ii) expression of intent to

be partners, (iii) the right to participate in control of the business, (iv) sharing or agreeing to share losses or liabilities, and (v) agreeing to or contributing money or assets to the business.[80]

In July 2014, the district court signed a judgment for ETP awarding more than $319 million in actual damages, $150 million in disgorgement of wrongfully obtained benefits, and more than $66 million in interest. Enterprise appealed.

The Court of Appeals[81] reversed the judgment against Enterprise, holding that ETP had failed to prove that the conditions precedent stated in the Letter of Intent had been satisfied or

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[80] *See Ingram v. Deere*, 288 S.W.3d 886, 895-96 (Tex. 2009), in which the Supreme Court of Texas held that while "common law required proof of all five factors to establish the existence of a partnership, . . . [the Texas Revised Partnership Act] TRPA does not require direct proof of the parties' intent to form a partnership" and instead uses a "totality-of-the-circumstances test" in determining the existence of a partnership. The Supreme Court in *Ingram v. Deere* explained:

Whether a partnership exists must be determined by an examination of the totality of the circumstances. Evidence of none of the factors under the Texas Revised Partnership Act will preclude the recognition of a partnership, and even conclusive evidence of only one factor will also normally be insufficient to establish the existence of a partnership under TRPA. However, conclusive evidence of all five factors establishes a partnership as a matter of law. In this case, Deere has not provided legally sufficient evidence of any of the five TRPA factors to prove the existence of a partnership. Accordingly, we reverse the court of appeals' judgment and reinstate the trial court's take-nothing judgment. *Id.* at 903-04. *See EGAN ON ENTITIES* at notes 119-131.

Texas does not require an express written or oral agreement to form a partnership, *See, e.g., Garcia v. Lucero*, 366 S.W.3d 275, 278 (Tex. App.—El Paso 2012, no pet.*) ("*The existence of a formal partnership agreement is not one of the five factors*."); Sewing v. Bowman,* 371 S.W.3d 321, 332 (Tex. App.—Houston [1st Dist.] 2012 pet. dism'd*) ("*Partnership formation may be implied from the facts and circumstances of a case*."); Ferch v. Baschnagel*, 03-04-00605-CV, 2009 WL 349149, at *9 (Tex. App.—Austin, Feb. 13, 2009) *("*It is well established that, 'even if an offer and acceptance are not recorded on paper, dealings between parties may result in an implied contract where the facts show that the minds of the parties met on the terms of the contract without any legally expressed agreement.'" [internal citations omitted*]); Shindler v. Marr & Associates,* 695 S.W.2d 699, 703 (Tex. App.—Houston [1st Dist.] 1985, writ ref'd n.r.e.) ("In order to establish a partnership de facto, neither a written nor an oral agreement is essential; a partnership relation may be implied from the facts and circumstances surrounding the transaction."). Texas, like the vast majority, if not all, jurisdictions, follows the Uniform Partnership Act and the Revised Partnership Act in this respect; partnership formation is adjudged on the factual circumstances rather than on the existence of a formal agreement.

This has always been the law in Texas. *See, e.g., Howard Gault & Son, Inc., v. First Nat'l Bank of Hereford*, 541 S.W.2d 235, 237 (Tex. Civ. App.—Amarillo 1976, no writ) ("The statement in one of the agreements that the farming operation was not a partnership is not conclusive on the question of partnership. It is the intent to do the things that constitute a partnership that determines that the relationship exists between the parties, and if they intend to do a thing which in law constitutes a partnership, they are partners whether their expressed purpose was to create or avoid the relationship."); *Fed. Sav. & Loan Ins. Corp. v. Griffin, 935 F.2d 691, 700 (5th Cir. 1991)* ("[A] statement that no partnership is formed cannot be conclusive proof that no partnership was formed."); *Shindler v. Marr & Assocs.*, 695 S.W.2d 699, 704 (Tex. App.—Houston [1st Dist.] 1985, writ ref'd, n.r.e.) ("It is the common intention to do the things that constitute a partnership that determines the relationship existing between the parties, whether the partnership agreement is oral or written, express or implied from the conduct of the parties in proceeding with the business of the partnership. If they intend to do a thing which constitutes a partnership, they are partners whether their express purpose was to create or avoid partnership.").

[81] *Enterprise Products Partners, L.P. v. Energy Transfer Partners, L.P.*, 529 S.W.3d 531 (Tex. App.—Dallas 2017).

waived. The Court rejected ETP's argument that the formation of a common law partnership between ETP and Enterprise was controlled solely by the five factor test in TBOC § 152.052. Instead, the Court of Appeals ruled that the TBOC § 152.052 five factors are non-exclusive. The conditions in the parties' Letter of Intent, which required board of directors approval and execution of definitive agreements, constituted conditions precedent that had to be satisfied before a partnership could be formed. The Court of Appeals concluded that:

1. The unfulfilled conditions precedent in the parties' written agreements precluded forming the alleged partnership unless ETP obtained a jury finding that the parties waived those conditions precedent;

2. ETP's failure to request such a finding meant that it had to establish waiver of the conditions precedent as a matter of law; and

3. ETP did not prove as a matter of law that the parties waived the conditions precedent.

The Court of Appeals therefore rendered judgment that ETP recover nothing from Enterprise. The Court of Appeals decision was appealed to the Supreme Court of Texas which in a unanimous decision affirmed the Court of Appeals and held:

> Parties can conclusively negate the formation of a partnership under Chapter 152 of the TBOC through contractual conditions precedent. ETP and Enterprise did so as a matter of law here, and there is no evidence that Enterprise waived the conditions.

In explaining its holding, the Supreme Court in *Energy Transfer Partners, L.P. v. Enterprise Products Partners, L.P.* wrote:

> Section 152.051(b) of the TBOC states that "an association of two or more persons to carry on a business for profit as owners creates a partnership, regardless of whether: (1) the persons intend to create a partnership; or (2) the association is called a 'partnership,' 'joint venture,' or other name." Under § 152.052(a),
>
> Factors indicating that persons have created a partnership include the persons':
>
> (1) receipt or right to receive a share of profits of the business;
>
> (2) expression of an intent to be partners in the business;
>
> (3) participation or right to participate in control of the business;
>
> (4) agreement to share or sharing:
>
> (A) losses of the business; or

(B) liability for claims by third parties against the business; and

(5) agreement to contribute or contributing money or property to the business.

Section 152.003 provides that "[t]he principles of law and equity and the other partnership provisions supplement this chapter unless otherwise provided by this chapter or the other partnership provisions."

In *Ingram v. Deere*, we traced the evolution of Texas partnership law from the early common law, which required proof of five factors to establish a partnership, to TBOC Chapter 152, which sets out a nonexclusive list of factors to be considered in a totality-of-the-circumstances test. Under § 152.052(a)(2), "expression of an intent to be partners in the business" is just one factor of the totality-of-the-circumstances test. We acknowledged in *Ingram* that the statute "does not by its terms give the parties' intent or expression of intent any greater weight than the other factors". Moreover, under § 152.051(b), persons can create a partnership regardless of whether they intend to. This provision derives from Section 202(a) of the Revised Uniform Partnership Act. A comment to that section drafted by the Uniform Law Commission warns that parties "may inadvertently create a partnership despite their expressed subjective intention not to do so." But in Ingram we expressed skepticism that the Legislature "intended to spring surprise or accidental partnerships on independent business persons". Can persons override the default test for partnership formation in Chapter 152 by agreeing not to be partners until conditions precedent are satisfied? Ingram did not involve such an agreement, and our discussion there of the role of intent in the partnership-formation analysis did not contemplate one.

Section 152.003 imports other "principles of law and equity" into the partnership-formation analysis, and the use of the word "include" in § 152.052(a) makes the factors enumerated there nonexclusive. Against this backdrop of statutory law is a well-developed body of common law that "strongly favors parties' freedom of contract."[82] Our decisions recognizing this policy are decades older than the TBOC or its predecessor statute.

* * * * *

> [I]f there is one thing which more than another public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by Courts of justice. Therefore, you have this paramount

[82] *Gym-N-I Playgrounds, Inc. v. Snider*, 220 S.W.3d 905, 912 (Tex. 2007).

> public policy to consider—that you are not lightly to interfere with this freedom of contract.[83]
>
> We reinforce this public policy virtually every Court Term. Texas courts regularly enforce conditions precedent to contract formation and reject legal claims that are artfully pleaded to skirt unambiguous contract language, especially when that language is the result of arm's-length negotiations between sophisticated business entities.
>
> * * * * *
>
> We maintain our view expressed a decade ago in Ingram that the Legislature did not "intend[] to spring surprise or accidental partnerships" on parties. Section 152.003 expressly authorizes supplementation of the partnership-formation rules of Chapter 152 with "principles of law and equity", and perhaps no principle of law is as deeply engrained in Texas jurisprudence as freedom of contract. We hold that parties can contract for conditions precedent to preclude the unintentional formation of a partnership under Chapter 152 and that, as a matter of law, they did so here.
>
> An agreement not to be partners unless certain conditions are met will ordinarily be conclusive on the issue of partnership formation as between the parties. "Performance of a condition precedent, however, can be waived or modified by the party to whom the obligation was due by word or deed." We agree with the court of appeals that under Texas Rule of Civil Procedure 279, ETP was required either to obtain a jury finding on waiver or to prove it conclusively. It has done neither.

The Supreme Court's opinion in *Energy Transfer Partners, L.P. v. Enterprise Products Partners, L.P.* makes clear that Texas embraces the principles of freedom of contract among sophisticated businesses and that they can trust that their legal documents will be enforced as written. This means that in Texas companies should be able to rely on conditions precedent to avoid an unintended partnership or joint venture.

IV. SCOPE AND PURPOSE

A central element of every joint venture is the scope of its business, both as to the types of products, services or technology which the venture is organized to provide, and as to the geographic area or markets in which they will be provided.[84] Where the business of the venture is

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83 *Wood Motor Co. v. Nebel*, 238 S.W.2d 181, 185 (Tex. 1951); *see also St. Louis Sw. Ry. Co. of Tex. v. Griffin*, 171 S.W. 703, 704 (Tex. 1914) ("The citizen has the liberty of contract as a natural right which is beyond the power of the government to take from him. The liberty to make contracts includes the corresponding right to refuse to accept a contract or to assume such liability as may be proposed.").

84 JOINT VENTURE TASK FORCE OF NEGOTIATED ACQUISITIONS COMMITTEE, *supra* note 3, at xv-xviii. The ABA Model Joint Venture Agreement was prepared based on an assumed fact pattern in which the proposed joint venture is a Delaware LLC with two members, one of whom has a 60% equity interest (***"Large Member"***) and one of which has a 40% equity interest (***"Small Member"***), and both of which are engaged in manufacturing and selling high tech equipment. They want to contribute their assets relating to existing

similar to the existing business of one or more of the venturers, it may be necessary to contractually define the activities that may be conducted by the venturers only through the venture and those which the parties may conduct separately.[85]

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products to the joint venture on its formation, and collaborate through the joint venture in developing and marketing the next generation of high tech equipment, which they know will have be smaller and more efficient. Although they are competitors, neither has a significant market share in their common products. Independently they will continue to manufacture and distribute other products. Based on this fact pattern, the ABA Model Joint Venture Agreement sets forth in recitals at the front definitions of the "Business" of the proposed joint venture and other terms that will be used throughout the Agreement to define the purposes of the joint venture, which in turn will be used to restrict other activities of the venturers elsewhere in the Agreement, as follows:

> A. Large Member, through its High Tech Division, and Small Member are each currently engaged in the research, development, manufacturing and distribution of _____ products ("Initial Products"), that each will manufacture on a toll basis for the joint venture and that will be distributed by the joint venture.
>
> B. Large Member, through its High Tech Division, currently distributes its Initial Products in the United States and elsewhere in the world, and Small Member currently distributes its Initial Products in the United States.
>
> C. Large Member and Small Member desire to form a joint venture as a Delaware limited liability company (the "Company") for the distribution of Initial Products and for the research, development, manufacture and distribution of _____ products that are not Initial Products ("New Products;" and with such activities as to the Initial Products and the New Products being the "Business").

[85] *Id.* at 48-49; 108-110. Article 15 of the ABA Model Joint Venture Agreement prohibits a member from competing with the joint venture during the period it holds an interest therein, and for a specified period thereafter, as follows:

> **Article 15: Competition**
>
> **15.1 Competition.**
>
> (a) *Generally*. Each Member will not, and will take all actions necessary to ensure that its Affiliates will not, engage in the activities prohibited by this Section 15.1. For purposes of this Section 15.1, the "Restricted Period" for a Member lasts for so long as it or any of its Affiliates owns any interest in the Company. In addition, in the case of a Member whose Member Interest is purchased pursuant to Article 10 (Buy-Sell in the Absence of Default) or pursuant to Article 11 (Buy-Sell Upon Default), the Restricted Period lasts until the last day of the 60th full calendar month following the date on which the purchase is closed. Further, in the case of a Member that does not continue the Company's Business following the dissolution of the Company in which the Company's Business is continued by the other Member or by a third party purchaser, the Restricted Period lasts until the last day of the 60th full calendar month following the date on which the Company is wound up.
>
> (b) *Restricted Activities*. Neither the Member nor any of its Affiliates will:
>
> (i) *Non-Competition*: during the Restricted Period, carry on or be engaged, concerned or interested directly or indirectly whether as shareholder, partner, director, employee, member, agent or otherwise in carrying on any business similar to or competing with the Business anywhere in the United States (other than as a holder of not more than five percent of the issued voting securities of any company listed on The Nasdaq Stock Market or any registered national securities exchange);
>
> (ii) *Non-Solicitation of Customers*: during the Restricted Period, either on its own account or in conjunction with or on behalf of any other Person, solicit or entice away or attempt to solicit or entice away from the Company as a customer for the products or

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

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services of the Business any Person who is, or at any time within the prior 24 months has been, a customer, client or identified prospective customer or client of the Company;

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

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

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

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

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

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

Because common law "business opportunity" doctrines may impose fiduciary duties on the partners to offer business opportunities to the venture,[86] joint venture agreements typically define carefully the scope of the contemplated business of the venture and the extent to which partners may compete with the venture or pursue opportunities that the venture might undertake. Often these matters are dealt with in a separate business opportunity agreement.

V. FUNDING

Mechanisms should be established for funding the joint venture's activities—both for initial funding and for additional funding during the life of the joint venture. The joint venture's governing documents should state the participants' rights and obligations to make mandatory and optional cash contributions, as well as mandatory and optional loans to the joint venture entity.[87]

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86 *See* supra notes 66-68 and related text; Byron F. Egan, *How Recent Fiduciary Duty Cases Affect Advice to Directors and Officers of Delaware and Texas Corporations*, University of Texas School of Law 37th Annual Conference on Securities Regulation and Business Law, Dallas, TX, February 13, 2015, at 10-11, 30-32, *available at* http://www.jw.com/wp-content/uploads/2016/05/1945.pdf; Byron F. Egan, *Good Faith, Fair Dealing and Other Contractual and Fiduciary Issues*, University of Texas School of Law 2009 Partnerships and LLCs Conference, Austin, TX, July 23, 2009, at 68-70, 78-85 and 102-11, *available at* https://www.jw.com/wp-content/uploads/2016/08/1220.pdf; Kevin G. Abrams and Srinivas M. Raju, *Recent Developments in the Corporate Opportunity Doctrine Under Delaware Law*, 10 Insights 2 (1996).

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

> **Article 3: Capital Contributions**
>
> **3.1 Initial Capital Contributions.** Immediately after the completion of the capital contributions for which Section 2.8 (Closing Deliveries) provides, the parties agree that the Book Capital Account of each Member is as follows:
>
> | Name | Initial Book Capital Account |
> |---|---|
> | Large Member | $ |
> | Small Member | $ |
>
> **3.2 Additional Capital Contributions and Member Loans.**
>
> (a) *Mandatory Only If Included in Business Plan*. Each Member will make additional capital contributions ("Additional Capital Contributions") or loans ("Member Loans") to the Company in accordance with its Member Interest, but only in the amounts and at the times set forth in the Business Plan as it may be amended from time to time. Neither Member is otherwise required to contribute capital or make Member Loans to the Company.
>
> (b) *Procedure*.

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

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

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

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

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

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

Typically, procedures will be put in place whereby the participants, either directly or through their representatives on the joint venture's Board, agree upon an annual budget for the venture.[88] Cash required from the participants to fund the venture's operations under the agreed

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if Shortfall Loans Outstanding). The Non-Contributing Member will repay the Shortfall Loan in 20 equal quarterly installments plus interest at the Specified Interest Rate. The Non-Contributing Member's failure to make any such payment when due is a Material Default under Section 8.2(a).

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

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

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

[88] *Id.* at 86-89. Section 5.8 of the ABA Model Joint Venture Agreement provides for business plans and budgets of the joint venture as follows:

5.8 Business Plan.

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

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

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

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

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

budget is then frequently provided on the call of the venture's senior manager, based on an agreed schedule. An issue related to the cash funding of the joint venture is the contribution of services, technology, products, or other assets to the joint venture. To the extent that a participant will be making any such non-cash contributions, a procedure should be established at the outset of the venture for the valuation of such contributions.

VI. ALLOCATIONS AND DISTRIBUTIONS

Subject to various limitations imposed by tax laws, the participants have great flexibility in structuring the allocation and distribution of profits, losses and other items.[89] For example,

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(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.

89 *Id.* at 35-38. Article 4 of the ABA Model Joint Venture Agreement provides for the allocation of profits and losses and distributions as follows:

Article 4: Allocation of Profits and Losses; Distributions

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

4.2 Definitions.

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

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

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

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

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

4.3 Distributions. Distributions are made in the following priority:

(a) *Distribution of Tax Amount.* At least ten Business Days before each date when a U.S. corporate estimated income tax payment is due, the Company will distribute, from Cash Flow from Operations (or, if necessary, from Other Available Cash), to each Member its share of the Tax Amount estimated by the Company to have accrued during the

estimated tax period before the distribution date. No later than 65 days after the end of the Company's Fiscal Year, the Company will distribute, from Cash Flow from Operations (or, if necessary, from Other Available Cash), to each Member its share of any previously unpaid Tax Amount for such Fiscal Year.

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

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

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

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

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

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

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

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

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

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

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

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

VII. GOVERNANCE AND MANAGEMENT

The venture's governing documents (whether in the form of a shareholders agreement, partnership or LLC agreement or otherwise) usually specify the mechanics of the overall governance and the day-to-day management of the venture's affairs.[90] Typically, this will involve

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balance of the Member. These balances will be determined after taking into account all Book Capital Account adjustments for the Company's Fiscal Year during which the liquidation occurs.

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

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

[90] *Id.* at 39-55. Sections 5.1 – 5.5 of the ABA Model Joint Venture Agreement provide for the governance of the LLC as follows:

5.1 Management Committee.

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

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

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.

5.2 Management Committee Meetings.

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

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

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

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

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

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

(g) *Notice*. Written notice of each special meeting of the Management Committee will be given to each Manager at least five Business Days before the meeting and will

identify the items of business to be conducted at the meeting. No business other than those items listed in the notice may be conducted at the special meeting, unless otherwise expressly agreed by all the Managers. The notice provisions of this Section may be waived in writing and will be waived by a Manager's attendance at the meeting, unless the Manager at the beginning of the meeting or promptly upon his arrival objects to holding the meeting or transacting business at the meeting and does not thereafter vote for or assent to action taken at the meeting.

5.3 Voting of Managers; Quorum.

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

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

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

5.4 Actions Requiring Management Committee Approval—Major.

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

(a) amendment of this Agreement;

(b) admission of additional Members;

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

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

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

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

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

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

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

(j) amendment of any Related Agreement.

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

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

a Board of the joint venture entity on which each of the participants may have representation more or less proportional to its percentage interest in the joint venture. Sometimes, provision is made for an independent member of the Board, appointed by the agreement of the participants, in order to protect against Board deadlock over operational issues.[91]

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

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

VIII. DEFAULTS

Joint venture agreements often specify the events constituting an event of default by a venture participant and the remedies of the other participants upon a default.[92] The participants'

(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.

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

92 Article 8 of the ABA Model Joint Venture Agreement defines and establishes remedial processes for defaults by venturers as follows:

Article 8: Dissolution and Other Rights Upon Default

8.1 Applicability. This Article applies only if (a) only one Member is a Defaulting Member, in which case the Non-Defaulting Member may elect to terminate the Company

in accordance with Section 8.3 (Remedies Upon Default by One Member), or (b) both Members are Defaulting Members, in which case Section 8.4 (Remedies if Both Members are Defaulting Members) will apply.

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

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

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

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

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

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

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

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

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

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

(h) *Insolvency Proceeding*. If any of the following occurs: (i) the Member seeks relief in any Proceeding relating to bankruptcy, reorganization, insolvency, liquidation,

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

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

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

8.3 Remedies—Upon Default by One Member.

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

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

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

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

(b) *Other Remedies*.

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

(ii) *Certain Other Rights*. Notwithstanding the foregoing, no election under Section 8.3(a) will preclude either (A) the appointment of additional Managers by Small Member under Section 8.3(c) if Small Member is the Non-Defaulting Member, (B) the

recourse by either the Defaulting Member or the Non-Defaulting Member to whatever injunctive relief to which it may otherwise be entitled under this Agreement or any Related Agreement or (C) the recourse by the Non-Defaulting Member under § 2.11(b) (Actions by Company) to recover amounts owing to the Company that are not specifically taken into account in the determination of Fair Market Value.

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

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

(i) if Small Member is the Non-Defaulting Member and it elects in its Default Notice the remedy in Section 8.3(a)(ii) (Right To Buy), it may, by simultaneously giving notice to the Defaulting Member and each Manager, also (A) appoint that number of additional Managers that will give Small Member a majority of the members of the Management Committee, (B) cause a simple majority of the members of the Management Committee to constitute a quorum, and (C) appoint the Chair of the Management Committee. Concurrently with that appointment, the appointee of Large Member will cease to be the Chair. However, in all cases the consent of at least one Manager appointed by each Member will continue to be required for the matters specified in Section 5.4 (Actions Requiring Management Committee Approval—Major); or

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

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

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

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

obligations to each other and to the joint venture may extend beyond funding and non-competition to such things as the provision of goods, services or personnel to the venture. A default in any of these obligations may be deemed a default under the joint venture agreement.

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

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

IX. RESTRICTIONS ON TRANSFER OF JOINT VENTURE INTERESTS

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

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

which specified individuals cease to be in control or (iii) a change in control of an ultimate parent entity.

X. DISPUTE RESOLUTION

The joint venture agreement may provide for any number of dispute resolution mechanisms, including litigation, arbitration or other alternative forms of dispute resolution.[93] Whatever the mechanism provided, it is frequently provided that before any participant resorts to any such mechanism the dispute must be referred to specified senior level officers or managers of each participant for resolution. It is also important to provide for continued operation of the joint venture entity during the pendency of any dispute.

XI. TERMINATION

The joint venture governing documents typically specify the events, if any, which will cause a termination of the joint venture. Some agreements include a "termination for convenience" provision, under which any participant can force a termination of the joint venture, perhaps after a set period of time such as five years.[94] The joint venture agreements often include an affirmative

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

> **5.9 Dispute Resolution Procedures.**
>
> (a) *Failure to Approve Actions Requiring Special Approval by Management Committee*. If the Management 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.

94 Article 8 of the ABA Model Joint Venture Agreement defines and establishes remedial processes for defaults by venturers and is set forth in note 92, *supra*. Article 7 of the ABA Model Joint Venture Agreement defines

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

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

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the venturers exit rights, either by dissolution or by purchase of sale of member interests, in the absence of a default as follows:

> **Article 7: Dissolution or Buy-Sell—in the Absence of Default**
>
> **7.1 Applicability.** This Article applies only if neither Member is a Defaulting Member (as defined in Section 8.2 (Definitions—Defaulting Member and Non-Defaulting Member and Default Event).
>
> **7.2 Triggering Events—Absence of Default.** Either Member may elect a remedy set forth in Section 7.3 upon the occurrence of either of the following events:
>
> (a) *Fundamental Failure*. The Company fails to achieve a Critical Target at the time specified in the Business Plan ("Critical Target Failure") that is not a result of a material breach by a Member and the Members fail to agree upon and implement a plan to remedy that failure within 30 days (or such longer period as may be agreed by the Members) after either Member or any Manager has given notice of the failure to the Members and to each Manager.
>
> (b) *Unresolved Business Dispute*. The occurrence of a Business Dispute unresolved under Section 5.9(b) (Consideration by Member Executives).
>
> **7.3 Remedies—Absence of Default.** A Member may, within 90 days of becoming aware of the occurrence of either of the events specified in Section 7.2, give notice of the event to the other Member. The notice must specify one of the following alternative remedies (which are exclusive remedies):
>
> (a) *Dissolution*. Dissolution of the Company in accordance with Article 9 (Dissolution Procedures).
>
> (b) *Mandatory Buy-Sell*. Initiation of the sale of its Member Interest or the purchase of the other Member's Member Interest by giving the notice specified in Section 10.1 (Offer to Buy or Sell).
>
> If both Members give notices within that time period, the notice given first prevails.
>
> **7.4 Voluntary Buy-Sell.** At any time after the third anniversary of the date of this Agreement (but not earlier), if no prior notice under Section 7.3 or Section 8.3 (Remedies—Upon Default of One Member) has rightfully been given, either Member may give a written notice to the other offering to purchase the other Member's Member Interest or sell its Member Interest to the other Member in accordance with Article 10 (Buy-Sell in Absence of Default).

XII. ANTITRUST

A. HSR Filing Requirements

Pre-merger notification filings under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (***"HSR"***) are generally required if all three of the following tests are met:[95]

(1) *The Commerce Test:* If either the acquiring and acquired person[96] is "engaged in commerce or any activity affecting commerce…;"[97]

(2) *The Size-of-Person Test:* (i) One person in the transaction has a net sales or total assets of at least $188 million in sales or total assets, **and** (ii) the other party has at least $18.8 million in sales or total assets; and[98]

(3) *The Size-of Transaction Test:* As a result of the transaction, (i) the acquiring person will hold an aggregate amount[99] of voting securities, non-corporate interests and assets of the acquired person valued at least $94 million,[100] **or** (ii) the acquiring person will hold an aggregate amount of voting securities and non-corporate interests and assets of the acquired person valued at more than $376 million regardless of the sales or assets of the acquiring and acquired persons.[101]

In the case of a joint venture, even though the persons contributing to the formation of the unincorporated entity and the unincorporated entity itself may, in the formation transaction, be both acquiring and acquired persons within the meaning of HSR, for the above tests, the contributors are deemed acquiring persons only and the joint venture is deemed the acquired person only.[102]

If an HSR filing were required, there could be a waiting period of at least 30 days before the joint venture could be consummated unless "early termination" were granted.[103]

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95 Clayton Act 7A, 15 U.S.C. § 18a. The thresholds are adjusted each year based on the percentage change in the U.S. gross national product for the fiscal year. The most recent adjustment for 2019 appeared at 85 Fed. Reg. 4985 (Jan. 28, 2020), and was effective on February 27, 2020.

96 16 C.F.R. § 801.2 (Nov. 15, 2013).

97 16 C.F.R. § 801.1(l) (July 16, 2018); 16 C.F.R. § 801.3 (Aug. 15, 1978).

98 85 Fed. Reg. 4985 (Jan. 28, 2020), effective February 27, 2020, *available at* https://www.govinfo.gov/content/pkg/FR-2020-01-28/pdf/2020-01423.pdf.

99 16 C.F.R. § 801.10 (July 19, 2011).

100 85 Fed. Reg. 4985 (Jan. 28, 2020), effective February 27, 2020, *available at* https://www.govinfo.gov/content/pkg/FR-2020-01-28/pdf/2020-01423.pdf.

101 85 Fed. Reg. 4985 (Jan. 28, 2020), effective February 27, 2020, *available at* https://www.govinfo.gov/content/pkg/FR-2020-01-28/pdf/2020-01423.pdf.

102 16 C.F.R. § 801.50(a) (Mar. 8, 2005).

103 Stephen M. Axinn, Blaine V. Fogg, Neal R. Stoll, Bruce J. Prager and Joseph P. Nisa, *Acquisitions Under the Hart-Scott-Rodino Antitrust Improvements Act: A Practical Analysis of the Statute & Regulations* 1-23 (New York: Law Journal Press 3d ed. 2013); *see also* HART-SCOTT-RODINO PREMERGER NOTIFICATION PROGRAM, Introductory Guide I, *What is the Premerger Notification Program? - An Overview*, http://www.ftc.gov/sites/default/files/attachments/premerger-introductory-guides/guide1.pdf (last revised Mar. 2009); and HART-SCOTT-RODINO PREMERGER NOTIFICATION PROGRAM, Introductory Guide II, *To File*

Under current HSR rules, the formation of a "non-corporate entity" - including joint ventures - is reportable if the above tests are satisfied and a party gains "control" of the entity as a result of the transaction.[104] The HSR rules define a "non-corporate interest" as "an interest in any unincorporated entity which gives the holder the right to any profits of the entity or in the event of dissolution of that entity the right to any of its assets after payment of its debts."[105] These unincorporated entities include, but are not limited to, joint ventures, general partnerships, limited partnerships, limited liability partnerships, limited liability companies, cooperatives and business trusts. The HSR rules also provide that "control" is held by a person or entity with rights to 50% or more of the profits of the entity, or 50% or more of the assets upon the entity's dissolution.[106]

B. HSR Filing Fee Thresholds

The HSR filing fee thresholds, as of February 27, 2020, are as follows:[107]

Filing Fee	**Value of Transaction ($ millions)**
$45,000	More than $94 but less than $188
$125,000	$188 to less than $940.1
$280,000	$940.1 or more

C. General Antitrust Considerations

Whether or not pre-merger notification is required, the prospective joint venturers need to analyze whether the joint venture will be considered unlawful under antitrust law. While there is no clear test, a number of legal standards in the relevant case law as well as agency opinions, consent orders, guidelines and speeches are summarized in the Federal Trade Commission (***"FTC"***) and U.S. Department of Justice (***"DOJ"***) Antitrust Guidelines for Collaborations Among Competitors, available at http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf. In addition, if the joint venture is sufficiently similar to a horizontal merger, then the DOJ/FTC Horizontal Merger Guidelines, http://www.justice.gov/atr/public/guidelines/hmg-2010.html may apply.

XIII. INTELLECTUAL PROPERTY

Under federal law, intellectual property rights are not assignable, even indirectly as part of a business combination transaction among affiliated parties, unless the owner has agreed otherwise. This presumption of non-assignability is based on the concept that allowing free

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or Not to File - When You Must File a Premerger Notification Report Form, http://www.ftc.gov/sites/default/files/attachments/premerger-introductory-guides/guide2.pdf (last revised Sept. 2008).

104 16 C.F.R. § 801.1(f)(1)(i) (July 16, 2018).

105 16 C.F.R. § 801.1(f)(1)(ii) (July 16, 2018).

106 16 C.F.R. § 801.1(b) (July 16, 2018).

107 FEDERAL TRADE COMMISSION, Filing Fee Information https://www.ftc.gov/enforcement/premerger-notification-program/filing-fee-information (last visited Mar. 31, 2020).

assignability would undermine the reward for invention. Where patent or copyright licenses constitute material assets to be contributed to a joint venture, the due diligence review should take into consideration not only the language of the license agreements, but also the federal law presumption against assignability of patent or copyright licenses.

In *Cincom Systems, Inc. v. Novelis Corp.*,[108] the U.S. Court of Appeals for the Sixth Circuit held that an internal forward merger between sibling entities constitutes an impermissible software license transfer, notwithstanding a state corporation statute that provides that a merger vests title to assets in the surviving corporation without any transfer having occurred.[109] The reasoning in the *Cincom* case follows that of *PPG Industries, Inc. v. Guardian Industries Corp.*,[110] which held that, although state law provided for the automatic transfer and vesting of licenses in the successor corporation in a merger without any transfer having occurred, an intellectual property license, based on applicable federal law, is presumed to be non-assignable and nontransferable in the absence of express provisions to the contrary in the license. *PPG* held the state merger statute was preempted and trumped by this federal law presumption of non-transferability.

In the joint venture context, the issue of ownership of intellectual property can be complex. During the pendency of the joint venture transaction, it is typical for the joint venture and its partners to enter into reciprocal licenses and, in some cases, technology sharing agreements that will provide the entire group a prescribed level of freedom to operate. The extent to which the joint venture would license independently developed technology to any or all of its partners may also be the subject of a specific negotiation between the parties in the context of non-competition and other restrictions delineating the scope of the joint venture's business and its relationship with the businesses of its partners. In addition, agreeing upon the ownership of the joint venture's intellectual property upon a termination of the joint venture is often a difficult process that is often best done at the time of formation. Relevant factors in this regard include whether the joint venture would develop its own inventions on the basis of a technology "chassis" contributed or licensed by one of the partners.

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108 581 F.3d 431, 433 (6th Cir. 2009).

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

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

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

110 597 F.2d 1090, 1093 (6th Cir. 1979), *cert. denied* 444 U.S. 930 (1979).

XIV. TRANSFERRING ASSETS TO A JOINT VENTURE

Transferring assets to a joint venture, including a division or a subsidiary, revolves around a purchase agreement between the buyer (the joint venture) and the selling entity (one of the joint venture parties) and sometimes its owners.[111] Purchases of assets are characterized by the acquisition by the buyer of specified assets from an entity, which may or may not represent all or substantially all of its assets, and the assumption by the buyer of specified liabilities of the seller, which typically do not represent all of the liabilities of the seller. When the parties choose to structure an acquisition as an asset purchase, there are unique drafting and negotiating issues regarding the specification of which assets and liabilities are transferred to the buyer, as well as the representations, closing conditions, indemnification and other provisions essential to memorializing the bargain reached by the parties. There are also statutory (e.g., bulk sales and fraudulent transfer statutes) and common law issues (e.g., de facto merger and other successor liability theories) unique to asset purchase transactions that could result in an asset purchaser being held liable for liabilities of the seller which it did not agree to assume.[112]

XV. LEGAL REPRESENTATION OF JOINT VENTURE

Typically, at the time of its formation, a joint venture will have neither a comprehensive internal legal function nor an established network of external counsel to which to turn for legal representation. Especially where a joint venture is established through the contribution of businesses formerly belonging to one or more venture partners, it will be convenient and efficient for the newly formed joint venture to turn to internal or external counsel of its partner-owners. Indeed, it is common for the joint venture transaction agreements to include transition or other services agreements between the joint venture and its partners pursuant to which the partners provide accounting, data processing, human resources and legal services to the joint venture until it is able to "stand up" on its own.

But legal services are different from other administrative services, in at least two important ways. First, lawyers are subject to ethical rules and duties that generally prohibit them from representing both sides in a transaction. And while a joint venture might be perceived as a friendly affair between partners pursuing a common objective, it is fraught with potential for disputes. There may be an issue with respect to assets or liabilities that had been contributed to or assumed by the joint venture, or the scope of a non-competition provision, or the terms or performance of a commercial agreement between the joint venture and a partner. As a result, the lawyer – whether internal or external – who is asked to act in this capacity should treat the situation as a classically

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111 For a detailed discussion of asset purchase transactions, *see* Bryon F. Egan, *Asset Acquisitions: Assuming and Avoiding Liabilities*, 116 PENN ST. L. REV. 913 (2012).

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

conflicted representation for which informed consent of both parties – the joint venture and the partner with which counsel has its primary relationship – should be obtained. On behalf of the joint venture, such consent should be furnished by the joint venture's management (if it is independent of the partners) or the other joint venture partners. In the case of internal counsel of a partner who furnishes legal advice to the joint venture, such consent should also address the extent to which he or she is permitted to share with other employees of the partner any information he or she gains through the representation of the joint venture. Circumstances in which such information sharing may be appropriate include discoveries of compliance violations or where the information relates to other services being furnished by the partner.

It is also important to consider whether communications between the joint venture and its partners – irrespective of whether legal counsel is shared – remain entitled to legal privileges that protect them from discovery. As a general rule, although the joint venture and its partners are legally independent, it should be possible for the joint venture and its partners to preserve such privilege by asserting the common interest doctrine.[113] Under the common interest doctrine, separate parties who share a common interest with respect to a legal matter can agree to protect each other's confidential information from disclosure.

[113] Byron F. Egan, *Acquisition Structure Decision Tree*, TexasBarCLE & Business Law Section of State Bar of Texas Choice and Acquisition of Entities in Texas Course, San Antonio, May 22, 2015 http://www.jw.com/wp-content/uploads/2016/05/2045.pdf, pages 275-281.