ABA PRACTICE ESSENTIALS
BOOK

MODEL LIMITED LIABILITY COMPANY

MEMBERSHIP INTEREST REDEMPTION AGREEMENT

BY THE SUBCOMMITTEE ON LIMITED LIABILITY COMPANIES, COMMITTEE ON PARTNERSHIPS AND UNINCORPORATED BUSINESS ORGANIZATIONS,
ABA SECTION OF BUSINESS LAW

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Model Limited Liability Company Membership Interest Redemption Agreement

By the Subcommittee on Limited Liability Companies, Committee on Partnerships and Unincorporated Business Organizations, ABA Section of Business Law

Introduction

This Model Limited Liability Company Membership Interest Redemption Agreement is an exploration and explanation of issues that arise in the drafting of redemption agreements. This Model Agreement does not presuppose applicable redemption provisions in the operating agreement. As such, the terms of this agreement have been (are being) negotiated between the Company, the Redeemed Member, and perhaps the Remaining Members. If applicable provisions of the operating agreement dictate the entire terms of a redemption, a separate agreement such as this may not be necessary. An agreement may be necessary if the operating agreement dictates some, but not all, terms of redemption.

There are a multitude of approaches to many aspects of a redemption. This Model Agreement recites alternative means of addressing many of the points, especially those dealing with the structure of the purchase price and, where payments are made over time, the status of the Redeemed Member before receipt of full payment. No implication should be drawn from the omission of a particular alternative that such alternative is somehow ineffective or is not "market." Even then, the annotations to the options provided will be helpful to the practitioner in assessing other alternatives.

This Model Agreement is not drafted against the background of a particular state's LLC act or general contract law. Drafters seeking to adopt the provisions of this document for use in a particular transaction will need to account for the applicable state law. Reference must be made as well to the applicable operating agreement and in some instances, articles/certificate of organization/formation.

The tax provisions incorporated and discussed in this document are based upon the Internal Revenue Code of 1986, codified at Title 26 of the United States Code, as amended through January 1, 2005 ("Code"). However, this document does not address particular issues of state and/or local taxation that may impact upon a particular redemption. Changes in the Internal Revenue Code, the regulations thereunder, and other regulatory and judicial guidance, as well as state and local tax law, need to be addressed in the preparation of a redemption agreement. It would be difficult to overemphasize the complexity of the tax issues that may arise in connection with a redemption as few issues are potentially more compli-

cated than determining the tax consequences of a member redemption. Both the Redeemed Member and the Remaining Members may have significant (and often unexpected) tax consequences. Among the potential issues of concern to either or both the Redeemed Member and the Remaining Members in any given situation are:

(i) potential gain or loss to the Redeemed Member under Code § 731;
(ii) deemed cash distributions to the Redeemed Member to the extent she is relieved of her share of Company debt under Code § 752;
(iii) evaluation by the Company and/or the Remaining Members of a so-called "Section 754 election" (if one is not already in effect) which may give rise to a basis step-up or step-down in the Company's remaining assets;
(iv) evaluation of the tax consequences to the Redeemed Member and the Remaining Members under Code § 736 which, if applicable, will categorize the liquidating distribution as one or more of: (x) a guaranteed payment; (y) a distributive share of Company income; or (z) a payment in exchange for the Redeemed Member's share of Company assets;
(v) disguised sale payments to the Redeemed Member pursuant to Code § 707(a)(2)(B), which in turn gives rise to a basis adjustment in one or more Company assets;
(vi) ordinary income treatment to the Redeemed Member to the extent she receives less than her share of Company inventory and "unrealized receivables" under the so-called "collapsible partnership" rules contained in Code § 751 and the regulations thereunder;
(vii) ordinary income to the Remaining Members to the extent that the Redeemed Member receives more than her share of Company inventory and unrealized receivables;
(viii) gain to the Remaining Members to the extent that appreciated Company assets (other than inventory or unrealized receivables) are distributed to a Redeemed Member who is treated as receiving less than her share of Company inventory and unrealized receivables;
(ix) gain recognition to either or both the Remaining Member, and the Redeemed Member if assets are distributed in kind in contravention of the so-called anti-mixing bowl rules contained in Code §§ 704(c)(1)(B) and 737; and
(x) potential deemed cash distributions to either the Redeemed Member or one or more of the Remaining Members by virtue of debt shifts under the debt basis allocation rules of Code § 751 and corollary distribution rules of Code § 731.

The discussion of these issues that appears in this Model Agreement merely hints at the types of issues which must be examined for each member being redeemed, the limited liability company, and those members who are not being redeemed. In all but the most simple situations, consultation with qualified tax counsel is advisable.

One especially daunting state law issue is whether or not this agreement constitutes an amendment of the operating agreement. The answer to that inquiry will depend upon the applicable state law and operating agreement. The outcome of that analysis will impact, among other issues, the required consent for the transaction. Consider, in one extreme, an operating agreement that requires unanimous consent for its amendment and provides "no Member may be redeemed by the Company." Clearly the consent of all members is required to effect the redemption as it will constitute either an amendment of the operating agreement or the waiver of a term of the agreement. At the other end of the spectrum might be the syndicated real estate venture whose operating agreement provides "the Manager, in her discretion, may cause the Company to redeem the Membership Interests of any Member, and no consent of the Members shall be required for the redemption." Assuming that the operating agreement does not otherwise conflict with this provision, it is clear that the redemption does not affect an amendment of the operating agreement. Most situations will fall between these two extremes. Assuming that amendment of the operating agreement will generally require a higher voting threshold than will a transaction in the ordinary course, and in some cases higher than that required for approval of an extraordinary transaction, counsel for the redeeming limited liability company will need to be careful that the required approval is garnered.

Counsel to the Company (as well as in some instances counsel to the Remaining Members) will need to be aware of the securities law implications of a redemption. As the membership interests will often be "securities" under federal and/or state securities laws, notwithstanding the absence of registration obligations, anti-fraud rules will attach. Furthermore, common law fraud rules will be applicable. Both issues may be addressed by disclosure.

Professor Elizabeth S. Miller of Baylor School of Law prepares an annual survey of LLC (and LLP) case law developments, of which the most recent version is *The Advent of LLCs and LLPs in the Case Law: A Survey of Cases Dealing with Registered Limited Liability Partnerships and Limited Liability Companies*, which appears in PARTNERSHIPS AND LLCS—IMPORTANT CASE LAW DEVELOPMENTS 2006 (American Bar Association, August 2006) (updated three times a year in *PUBOGRAM*, the newsletter of the ABA Section of Business Law's Committee on Partnerships and Unincorporated Business Organizations). This unique and invaluable work is the source of most of the case law references included in this Model Agreement.

This Model Agreement is ***not*** intended to be a "form" agreement, and it would be entirely inappropriate to substitute the names of the entity and of the members into this document and then believe that an effective and appropriate redemption agreement had been drafted. A common problem is the use of forms from other transactions that do not meet the current transaction's unique needs. While forms are an excellent way for practitioners to avoid reinventing the wheel each time they assist a client in a transaction, practitioners must remember that each form utilized has more than likely been negotiated and, therefore, may contain provisions that were favorable to one side or the other and that may have unintended consequences in the current transaction. Each redemption agreement needs to

incorporate the particulars of the agreement negotiated among the entity and the member(s) (and in certain instances with managers and third-parties such as lenders). The drafter of a redemption agreement must investigate the issues and prepare the appropriate document for the particular transaction.

This Model Limited Liability Company Membership Interest Redemption Agreement is a project of the Limited Liability Company Subcommittee of the Committee on Partnerships and Unincorporated Business Organizations, Section of Business Law, American Bar Association. The Limited Liability Company Subcommittee has organized a series of task forces to draft and annotate transactional document for the organization of and transactions involving unincorporated business organizations. This Agreement is the first product of those efforts. Drafting began in the summer of 2004, and the initial draft was reviewed at a meeting of the task force held in conjunction with the 2004 ABA Annual Meeting in Atlanta. Thereafter various contributors provided written comments to the reporter, and revised drafts were reviewed at task force meetings held in conjunction with ABA meetings in Washington, D.C. (November 2004), Nashville, Tennessee (April 2005), and Chicago, Illinois (August 2005). The final agreement, subject to final editorial review, was approved by the Limited Liability Company Subcommittee in November 2005.

This model agreement is the product of contributions from many individuals over several years. The following should be recognized for their efforts: Paul M. Altman; Cecelia A. Cordova; Laura A. D'Angelo; Daniel H. Devaney IV; Allan G. Donn; Steven G. Frost; Gary L. Hoffman; J. Nelson Irvine; Lewis R. Kaster; Robert R. Keatinge; Scott E. Ludwig; John R. Maxfield; Ira Meislik; Professor Elizabeth S. Miller; Thomas A. Mullen; Gerald V. Niesar; Laura H. Pulliam; Thomas E. Rutledge, Co-chair; Sherwin P. Simmons, Co-chair; Thomas E. Rutledge, Reporter.

TABLE OF CONTENTS

1. Definitions 1204
1.01. "Act" 1204
1.02. "Affiliate" 1204
1.03. "Change of Control Transaction" 1204
1.04. "Claim" 1204
1.05. "Closing Date" 1204
1.06. "Code" 1204
1.07. "Company" 1204
1.08. "Company Counsel" 1204
1.09. "Control of the Company" 1204
1.10. "Effective Time" 1205
1.11. "Exculpated Party" 1205
1.12. "Initial Installment" 1205
1.13. "Interest" 1205
1.14. "Manager" 1205
1.15. "Member" 1205

1.16. "Operating Agreement" 1205
1.17. "Promissory Note" 1206
1.18. "Redemption" 1206
1.19. "Redemption Consideration" 1206
1.20. "Redemption Price" 1206
1.21. "Releasor" 1206
1.22. "Remaining Members" 1206
1.23. "Transfer" 1206
2. Redemption of the Interest; Redemption Price 1206
3. Other Consideration for Redeemed Member's Interest 1210
4. Adjustments to Redemption Consideration 1212
5. Representations and Warranties of the Company 1214
6. Representations and Warranties of the Redeemed Member 1216
7. Solvency of the Company 1217
8. Mutual Release 1217
9. Indemnification 1218
10. Income Tax Matters 1220
11. Withdrawal and Resignation 1221
12. Confidentiality and Competition 1221
13. Amendment of the Operating Agreement 1225
14. Other 1226
Exhibit 2(e){(i)} Redeemed Member's Wiring Instructions 1232
Exhibit 2(e)(ii) Promissory Note 1232
Exhibit 3 Description of Indebtedness 1232
Exhibit 6(c) Code § 1445(b)(2) Affidavit 1232
Exhibit 10(a) Company Tangible Property Fair Market Values 1232
Exhibit 12(c) Covenant Not to Compete 1232
Exhibit 14(m) Addresses of the Parties 1233
Schedule 2(b)(i) Delivery Obligations of the Company at Closing 1234
Schedule 2(b)(ii) Delivery Obligations of the Redeemed Member at the Closing 1234

MODEL[1] MEMBERSHIP INTEREST REDEMPTION AGREEMENT[2]

THIS MODEL MEMBERSHIP INTEREST REDEMPTION[3] AGREEMENT (this "Agreement") is made and entered into as of the ___ day of _____, 2___, by and among Exceptional Widgets, LLC, a limited liability company organized pursuant to the laws of the {State} {Commonwealth} of _____ (the "Company"), and Martha Hamilton,[4] an individual (the "Redeemed Member") {and the "Remaining Members"}.[5]

1. The annotations to this model agreement are not state specific. Rather, as they relate to state law, they are intended to identify points that require particular attention to the applicable statute. The lack of uniformity in limited liability company acts mandates such attention. References to the "PROTOTYPE" are to the Prototype Limited Liability Company Act (1992). References to "ULLCA" are to the Uniform Limited Liability Company Act (1996), and references to "ReULLCA" are to the Revised Uniform Limited Liability Company Act (2006 Annual Meeting Draft). References to "RUPA" are to the Uniform Partnership Act (1997). References to "ULPA" are to the Uniform Limited Partnership Act (2001). References to the "MBCA" are to the Model Business Corporation Act as amended through December 31, 2004.

This model agreement is *NOT* a form that may be completed by filling in the various blanks. In certain instances there are multiple approaches that, depending upon the desired deal, may be taken. The fact that a provision is not presented in alternative formulations is not an indication that there are not other and equally valid approaches to the concept being addressed. It is incumbent upon the drafter to see that the agreement clearly describes the desired transaction. The drafter would be well served to follow the guidance in HOWARD DARMSTADTER, HEREOF, THEREOF, AND EVERYWHEREOF—A CONTRARIAN GUIDE TO LEGAL DRAFTING (2002) [hereinafter "Darmstadter"] and KENNETH A. ADAMS, A MANUAL OF STYLE FOR CONTRACT DRAFTING (2004) to increase the readability of the final document. Neither the presence nor the absence of a particular provision should be taken as an indication that it is or is not "market."

2. This model agreement is based upon one prepared by Robert R. Keatinge. *See* Robert R. Keatinge, *Sample Buyout Agreement*, LIMITED LIABILITY ENTITIES IN TIMES OF CHANGE, ALI-ABA (March 12, 2002), available on Westlaw at VPC0312 ALI-ABA 349.

3. Personal preference and/or local convention could lead to this agreement being identified as a "repurchase," a "liquidation," or a "buy back," as contrasted with a "redemption," agreement. "Redemption" is used herein as that term is used in DEL. CODE ANN. § tit. 6 § 18-702(e) (2005) and FLA. STAT. ANN. § 608.432(5) (West 2001 & Supp. 2006).

4. The original efforts for the formation of the limited liability company were on behalf of Hamilton Brothers Oil. *See* Susan Pace Hamill, *The Origins Behind the Limited Liability Company*, 59 OHIO ST. L. J. 1459, 1463 nn.13–26 and accompanying text (1998); William J. Carney, *Limited Liability Companies: Origins and Antecedents*, 66 U. CO. L. REV. 855, 857 nn.4 and 5 and accompanying text (1995).

5. Whether the Remaining Members should be a party to the Agreement depends on a variety of factors. In a small limited liability company in which all of the members are active in day to day management, it may be appropriate for the Remaining Members to be parties to the Agreement. In contrast, if the limited liability company is centrally managed through a manager and there are a number of passive members, it is likely more appropriate for the Agreement to be between only the Company and the Redeemed Member. This model agreement is drafted under the assumption that the Remaining Members are *not* parties to the Agreement. If they are to be parties, the drafter will need to address matters including: (i) representations and warranties to be made by the Remaining Members to the Redeemed Member; (ii) representations and warranties to be made by the Redeemed Member to the Remaining Members or, in the alternative, having the Redeemed Member's representative and warranties being made jointly to the Company and the Remaining Members; (iii) any deliveries by or to the Remaining Members; (iv) whether the Remaining Members are joint obligors with the Company on the obligation to pay the Redemption Price/Consideration; (v) whether the Remaining Members are individually beneficiaries of the Redeemed Member's indemnification obligations; and (vi) any indemnification obligations of the Remaining Members.

RECITALS:

WHEREAS, the Redeemed Member is a Member of the Company and a party to the Operating Agreement; and

WHEREAS, the Company is classified, for purposes of federal income taxation, as a partnership;[6] and

WHEREAS, on the terms and conditions set forth in this Agreement, the Company desires to redeem from the Redeemed Member, and the Redeemed Member desires to sell to the Company, the entirety of the Redeemed Member's Interest;[7] and

WHEREAS, each of the Company and the Redeemed Member has had opportunity to independently consider the tax consequences of the transaction provided for herein;[8] and

WHEREAS, in connection with the redemption of the Redeemed Member's Interest (the "Redemption"), the Company and the Redeemed Member desire to memorialize the rights, duties, and obligations of each after the Redemption.

NOW, THEREFORE, in consideration of these premises, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, it is agreed that the statements set forth in the recitals above are true and correct and are incorporated herein and made a part hereof, and that the parties hereto agree as follows:

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6. It is assumed that the limited liability company in question is classified as a partnership for purposes of federal income tax and is governed by Subchapter K. The state law issues addressed in this model agreement remain applicable if the limited liability company has elected (Form 8832; Form 2553) to be classified as an association taxable as a corporation governed by Subchapter C or Subchapter S. However, the discussion of the tax implications under Subchapter K will not be applicable. For a discussion of the tax consequences of a redemption when the limited liability company is taxed under either Subchapter C or Subchapter S, *see*, *e.g.*, HOWARD M. ZARITSKY, STRUCTURING BUY-SELL AGREEMENTS (2d ed. 2000), at chapters 2 and 4.

7. The use of "entire" is somewhat redundant as it is incorporated in the definition of "Interest." However, its use in this recital makes clear that this Agreement contemplates a complete, as contrasted with a partial, redemption. The tax consequences of a partial redemption are not necessarily the same as a complete redemption. *See generally* James A. Doering, *Disposition of Less Than an Entire Partnership Interest: What Are the Tax Effects?*, 15 J. PARTNERSHIP TAX'N 141 (Summer 1998).

8. This model agreement does not purport to detail in full the tax ramifications of either the transaction described herein or the innumerable other approaches that could be taken. Relatively common alterations in the facts, including but in no way limited to a partial rather than a complete redemption or a distribution of property other than cash as part or all of the Redemption Price would add substantial complexity to the tax analysis. A careful review of the proposed transaction by qualified tax professionals, preferably by one on behalf of the Company and another on behalf of the Redeemed Member, is warranted. It needs to be pointed out that the redemption of a partnership/LLC interest is treated much differently for tax purposes than is the redemption of shares in a corporation. This difference is significant due to the fact that as a general rule with a redemption of corporate shares it is not necessary to look into the corporation to determine the character (i.e., ordinary versus capital) of the corporation's assets. Rather, generally it is necessary only to look at whether the shares have been held for more or less than twelve months. In contrast, the character of a redeeming partner's/member's gain as capital and/or ordinary is largely determined with reference to the character of the underlying assets of the partnership/LLC. In some cases, one or more Remaining Members will wish to have their own tax advisors review the transaction.

1. Definitions

For purposes of this Agreement, the following definitions shall apply:

1.01. "Act" shall mean the limited liability company act of the {State} {Commonwealth} of _____ {as in effect on the date hereof} {as amended from time to time}.

1.02. "Affiliate" shall mean any person, officer, director, shareholder, member, partner, manager, beneficial owner, trustee, employee, participant, agent, heir, executor, administrator, personal representative, successor, assignee, or entity, directly or indirectly controlling, controlled by or under common control by either the Redeemed Member or the Company including any employee, attorney, advisor, lender, accountant or agent of either the Redeemed Member or the Company.

1.03. "Change of Control Transaction" shall mean any transaction or series of transactions (other than this Agreement), the consummation of which results in a change of Control of the Company or its business. "Change of Control Transaction" includes (i) a merger or consolidation of the Company with or into another entity, (ii) the sale, transfer or other disposition of all or substantially all of the assets of the Company, and (iii) the sale, transfer or other disposition by the Remaining Members (or any one or more of them) of Company membership interests sufficient to permit the transferees, upon admission as members, to constitute Control of the Company. A transaction shall not constitute a Change of Control Transaction if its sole purpose is to change the jurisdiction of the Company's organization or to create a holding company that will be owned in substantially the same proportions by the Remaining Members as constituted immediately before such transaction.

1.04. "Claim" shall mean any action, cause of action, suit, debt, due, sum of money, account, reckoning, bond, bill, specialty, covenant, contract, controversy, agreement, promise, variance, trespass, damage, judgment, extent, execution, claim, demand or chose in action whatsoever, in law, admiralty or equity (including, without limitation, court costs and reasonable attorneys' fees).

1.05. "Closing Date" shall mean _____.

1.06. "Code" means the Internal Revenue Code of 1986, as amended.[9]

1.07. "Company" shall mean Exceptional Widgets, LLC.

1.08. "Company Counsel" shall mean the law firm of Dewey Cheatem & Howe LLP.

1.09. "Control of the Company" shall mean the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the Company, whether through the ownership of membership interests, by contract or otherwise. The holders of a majority in interest of the Company's membership interests, acting in concert to exercise a controlling influence over the management or policies of the Company pursuant to the Operating Agreement

9. See http://www.corplawblog.com/archives/000335.html which discusses, in a somewhat jocular manner, the "as amended" conundrum.

or other arrangement, shall be presumed to have Control of the Company in the absence of proof by a preponderance of the evidence to the contrary.

1.10. "Effective Time" shall have the meaning set forth in Section 2(c).

1.11. "Exculpated Party" shall have the meaning set forth in Section 8(a) or 8(b), as applicable.

1.12. "Initial Installment" shall have the meaning set forth in Section 2(e)(i).[10]

1.13. "Interest" shall mean the entirety of the Redeemed Member's right, title, and interest in the Company, including without limitation all rights under the Operating Agreement.[11]

1.14. "Manager" shall have the meaning set forth in section ___ of the Operating Agreement.[12]

1.15. "Member" shall have the meaning set forth in section ___ of the Operating Agreement.[13]

1.16. "Operating Agreement" shall mean the Operating Agreement of the Company originally adopted by the parties thereto on the ____ day of _____, ____, and as amended on the ___ day of _____, ____, which Operating Agreement has not otherwise been modified, amended or supplemented by oral agreement or the course of conduct of the Members.[14]

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10. This defined term is used in only one of the optional provisions for Section 2(e).

11. Special attention should be paid to both applicable state law as well as the terms of the applicable operating agreement regarding the definition of a member's "interest" in a limited liability company. Certain limited liability company acts, as well as certain operating agreements, define the interest, sometimes referred to as a "membership interest" or a "limited liability company interest," as encompassing all economic rights of membership as well as any governance rights that may relate thereto. *See*, *e.g.*, FLA. STAT. ANN. § 608.402(23) (West 2001 & Supp. 2006), KY. REV. STAT. ANN. § 275.015(9) (LexisNexis 2003), *amended by* 2006 Ky. Laws Ch. 149 (H.B. 234). Other state statutes define the member's interest in the limited liability company as being the economic rights of membership without reference to any related governance rights. *See*, *e.g.*, COLO. REV. STAT. § 7-80-102(10) (2005); DEL. CODE ANN. tit. 6 § 18-101(8) (2005). *See also* RUPA § 502. Care should be taken in any redemption agreement to carefully define what is being acquired to ensure that, to the degree desired, the Redeemed Member's relationship with the Company is terminated. *See also* Section 2(a); Sherrets v. The Lund Company, No. A-97-1350, 1999 WL 502138 (Neb. Ct. App. July 6, 1999) (A limited liability company member who was bought out pursuant to a push-pull provision in the limited liability company operating agreement claimed that he was entitled to a portion of net rental income held by a third party under a property management agreement at the time of the closing of the sale of the member's interest. The court examined the operating agreement and the property management agreement and agreed that the member was entitled to recover a portion of the net rental. The court viewed the member as a third party beneficiary of the property management agreement executed by the limited liability company and disagreed with the defendant's argument that the member assigned his interest in the disputed funds when he sold his interest in the limited liability company.).

12. This definition assumes that the Company is manager-managed. If not, this definition may be deleted.

13. The incorporation of definitions from the Operating Agreement has the advantages of ease and of consistency. However, it brings with it the danger that the term may incorporate aspects that are not desired in the document to which they are applied. As such, special care should be used when definitions are incorporated from other documents.

14. Defining the operating agreement in a comprehensive manner is important as most states permit oral and course of conduct operating agreements. Furthermore, oral agreements and course of conduct may often supplement a written agreement, even one that purports to be exclusively in writing and that precludes oral and/or course of conduct modification. *See*, *e.g.*, Vinaird v. Bodkin's Adm'x, 72 S.W.2d 707 (Ky. 1934) (The power to modify or rescind pre-existing contract is coextensive with power to initiate contract prevails although contract recites that no modification shall be made except

1.17. "Promissory Note" means the {secured} {unsecured} Promissory Note dated _____ in the principal amount of _____ to be executed by the Company, as Maker, payable to the Redeemed Member, as Holder, in the form set forth as *Exhibit 2(e)(ii)*.

1.18. "Redemption" shall mean the transaction described in Section 2(a).

1.19. "Redemption Consideration" shall mean the Redemption Price plus the further consideration described in Section 4.[15]

1.20. "Redemption Price" shall mean the payment by the Company to the Redeemed Member described in Section 2(e).

1.21. "Releasor" shall have the meaning set forth in Section 8(a) or 8(b), as applicable.

1.22. "Remaining Members" shall mean all persons, except the Redeemed Member, who are identified as Members in the Operating Agreement as of the date hereof.[16]

1.23. "Transfer" shall mean an assignment, conveyance, encumbrance, exchange, pledge, hypothecation, lease, mortgage, sale or other disposition for consideration, or gift or other disposition for no consideration, whether voluntary, involuntary, by operation of law or otherwise.

2. Redemption of the Interest; Redemption Price

(a) Upon the terms and subject to the conditions set forth in this Agreement, the Company agrees to redeem[17] from the Redeemed Member, and the Redeemed Member agrees to the redemption by the Company of the Interest.

(b) At the Closing,[18] which shall be held on the Closing Date:

(i) the Company shall deliver to the Redeemed Member the items identified on *Schedule 2(b)(i)* as delivery obligations of the Company; and

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in writing); L.K. Comstock & Co., Inc. v. Becon Const. Co., Inc., 932 F. Supp. 906 (E.D. Ky. 1993) (Written contract can be modified or abandoned by subsequent oral agreement); Mar-Lan Industries, Inc. v. Nelson, 635 S.W.2d 853 (Tex. Ct. App. 1982) (Written contract can be modified by subsequent oral agreement even though contract provides it may be modified only in writing); 17A *Contracts* Am.Jur.2d § 514 n. 3 (2004). Other states have allowed oral/course of conduct modification of a written operating agreement only to the extent that the written operating agreement will control in the case of inconsistency. *See*, *e.g.*, Fla. Stat. Ann. § 608.423(1) (West 2001 & Supp. 2006). To date, it does not appear that a court has interpreted a statutory provision (*see, e.g.*, Ky. Rev. Stat. Ann. § 275.015(14) (LexisNexis 2003), *amended by* 2006 Ky. Laws Ch. 149 (H.B. 234)) providing for the specific enforcement of a provision in an operating agreement limiting the manner of amendment.

Note that the statement as to the modification/amendment/supplementation of the Operating Agreement likely is not binding upon the Remaining Members if they are not parties to the Agreement.

15. This definition will not be used if the Redemption Price is the entire consideration for the redemption, in which instance provisions of the type described in Section 4 will not appear in the final agreement.

16. This definition is used in this Agreement even though the Remaining Members are not parties to the Agreement. This definition assumes that no other Member, a Remaining Member at the time this Agreement is entered into, will be redeemed prior to the time this Agreement is fully performed.

17. See *supra* note 3 regarding terminology.

18. Consider whether the Agreement needs to further define the time and place of the Closing.

(ii) the Redeemed Member shall deliver to the Company the items identified on *Schedule 2(b)(ii)* as delivery obligations of the Redeemed Member.[19]

(c) The time of delivery {of the Redemption Price} {of the Redemption Consideration} {of that portion of the Redemption Price described in Section 2(e)(i)} on the Closing Date shall be the "Effective Time."

(d) Subject to Section 4, the Redemption Price shall be $_____ (the "Redemption Price").[20]

There follow four alternative provisions for § 2(e)

(e) The Redemption Price[21] shall be paid at Closing {by wire transfer of immediately available federal funds pursuant to the instructions provided by the Redeemed Member as set forth on *Exhibit 2(e)* attached hereto and made a part hereof} {by certified check} {in cash}.[22] At the time of delivery to the Redeemed

19. If the Remaining Members are parties to the Agreement, add a provision regarding their delivery obligations.

20. This Model Agreement contemplates a redemption for cash, a promissory note, or a combination of the two. However, if limited liability company property is to be distributed in kind, as part or all of the redemption consideration, a not uncommon practice, a number of issues should be carefully evaluated by the tax advisors for each of the Redeemed Member and the Company (and possibly also for the Remaining Members). Although the general rule is that in-kind distributions are tax free, the exceptions are many and they often trigger unexpected taxable gain to either or both the Redeemed Member or Remaining Members. If the Redemption Price/Consideration is not subject to adjustment, delete "Subject to Section 4,".

21. For tax purposes, the price paid to the Redeemed Member will include not only cash (or other property) actually received in redemption of the Redeemed Member's Interest, but also the Redeemed Member's share of Company liabilities which immediately prior to the redemption were for tax purposes allocated to the Redeemed Member pursuant to Code § 752 and that after the redemption for state law purposes remain with the Company and for tax purposes with the Remaining Members.

22. Immediate payment in full avoids many issues. To the extent payments are made over time, several issues need to be addressed, such as: (1) whether the Redeemed Member continues to be a Member until paid in full; (2) how the Redeemed Member can protect herself against adverse changes in the operation of the Company over the redemption period; (3) how the outstanding payment obligation will be secured, if at all; (4) whether the Redeemed Member will be treated as a partner for tax purposes over the period that payments are being made; (5) continuing information rights over the period that payments are being made; and (6) potential personal liabilities that could be imposed under statutes such as Code §§ 6671 and 6672 (responsibility for withholding taxes) or state law statutory exceptions to the generally prevailing rule of limited liability. *See*, *e.g.*, KY. REV. STAT. ANN. §§ 138.448(1), 139.185, and 141.340(3) (LexisNexis 2006), *all amended by* 2006 Ky Laws Ch. 149 (H.B. 234) (imposing upon the managers of a manager-managed limited liability company and upon the members of a member-managed limited liability company joint and several liability for, respectively, gasoline and special fuels taxes, sales and use taxes, and withholding taxes); VA. CODE ANN. § 58.1-1813 (2004) (imposing personal liability on certain LLC managers or members for remission of local admission, transient occupancy, food and beverage, or daily rental property taxes); Peyton v. State of Newburg, Inc., 786 N.Y.S. 2d 458 (N.Y.A.D. 2004) (members of a limited liability company treated as owners of real property for purposes of obligation of "owner" to install smoke detectors in rental properties)). *See generally* Thomas E. Rutledge, *Limited Liability (or Not): Reflections on the Holy Grail*, 51 SOUTH DAKOTA L. REV. 417 (2006); Alan G. Donn, *Is the Liability of Limited Liability Entities Really Limited?*, CHOICE OF ENTITY-2006 (ALI-ABA Feb. 2, 2006), available on Westlaw at VML0202 ALI-ABA 23. It may be advantageous to the Redeemed Member to receive the Redemption Price over the course of two or more years in order to take advantage of installment sale treatment. Code § 453;

Member of the Redemption Price as provided herein, the Interest shall be redeemed by the Company without the necessity of further action by any person, and the Redeemed Member shall cease to be a Member of the Company.

– or –

(e) The Redemption Price shall be paid as follows:
  (i) $_____ shall be delivered to the Redeemed Member at closing {by wire transfer of immediately available federal funds pursuant to the instructions provided by the Redeemed Member as set forth on *Exhibit 2(e)(i)* attached hereto and made a part hereof} {by certified check} {in cash};
  (ii) the balance of the Redemption Price shall be paid in accordance with the terms of the Promissory Note in the form attached hereto as *Exhibit 2(e)(ii)*;[23] and
  (iii) at the time of the delivery to the Redeemed Member of the Redemption Consideration as provided herein, the Interest shall be transferred to the Company without the necessity of further action by any person, and the Redeemed Member shall cease to be a Member of the Company.[24]

– or –

(e) The Redemption Price shall be paid as follows:
  (i) $_____ shall be delivered to the Redeemed Member at closing {by wire transfer of immediately available federal funds pursuant to the instructions provided by the Redeemed Member as set forth on

Code § 731; Treas. Reg. § 1.731-1(a)(1) (codified at 26 C.F.R. § 1.731-1(a)(1) (2005)). If so, the Redeemed Member's tax advisor should determine whether and to the extent the redemption will qualify for installment sales treatment. *See* WILLIAM S. MCKEE, WILLIAM F. NELSON & ROBERT L. WHITMIRE, FEDERAL TAXATION OF PARTNERSHIPS AND PARTNERS, ¶¶ 21.03[6][c]; 16.05 (3d ed. 1997).

23. Whether the Promissory Note should be secured or unsecured, and the nature of the security provided, is a matter of negotiation. Depending upon the circumstances, the Redeemed Member may seek to have some or all of the Remaining Members guarantee the Promissory Note.

24. Consider whether this provision should as well or in substitution provide that the Redeemed Member shall cease to be a party to or beneficiary of the Company Operating Agreement. *See also Sherrets v. The Land Company*, *supra* note 11. This point may be important in those jurisdictions that expressly allow non-members to be parties to or have rights under an operating agreement. *See*, *e.g.*, DEL. CODE ANN. tit. 6 § 18-101(7) (2005).

This option for the payment of the Redemption Price specifies that, upon the initial payment, the Redeemed Member ceases to be a member of the limited liability company. After that payment, her rights with respect to the limited liability company would be determined by reference to the Promissory Note (and any security and related documents) and not by reference to the Operating Agreement. *See*, *e.g.*, Landskroner v. Landskroner, 797 N.E.2d 1002 (Ohio Ct. App. 2003); Lindsay, Marcel, Harris & Pugh, L.L.C. v. Harris, 752 So. 2d 335 (La. Ct. App. 2000). As a former member, the Redeemed Member will not have the right to bring an action for dissolution of the Company unless the applicable act provides that right to creditors. *See*, *e.g.*, ME. REV. STAT. ANN. tit. 31, § 702(2) (1996); UTAH CODE ANN. § 48-2c-1210(3) (2002). If the Operating Agreement or the controlling Act provide a different result, consider whether this Agreement needs to be treated as an amendment to the operating agreement. *See* Section 13.

Exhibit 2(e)(i) attached hereto and made a part hereof} {by certified check} {in cash} (the "Initial Installment");

(ii) the balance of the Redemption Price shall be paid in accordance with the terms of the Promissory Note in the form attached hereto as *Exhibit 2(e)(ii)*;

(iii) upon payment of the Initial Installment as described in Section 2(e)(i), a portion of the Interest equal to the percentage of the Redemption Consideration satisfied by the Initial Installment in the Company shall be redeemed, and the Redeemed Member's Interest in the Company shall be further reduced proportionally as payments are made on the Promissory Note;

(iv) except as may be otherwise provided in this Agreement, the Redeemed Member shall remain a Member of the Company until such time as the Promissory Note is satisfied in full; and

(v) from the Effective Time, no further allocations of Company income, loss, deduction, or credit shall be made to the Redeemed Member's capital account, and the Redeemed Member shall receive no distribution from the Company except those provided for in this Agreement.[25]

– or –

(e) The Redeemed Price shall be paid as follows:

(i) $_____ shall be delivered to the Redeemed Member at closing {by wire transfer of immediately available federal funds pursuant to the instructions provided by the Redeemed Member as set forth on *Exhibit 2(e)(i)* attached hereto and made a part hereof} {by certified check} {in cash};

(ii) the balance of the Redemption Price shall be paid in accordance with the Promissory Note in the form attached hereto as *Exhibit 2(e)(ii)*;

(iii) at the time of the delivery to the Redeemed Member of the Redemption Consideration as provided herein, the Interest shall be Transferred to the Company without the necessity of further action by any person, and the Redeemed Member shall cease to be a Member of the Company; and

25. Under this option, the Redeemed Member will remain a member of the Company through the period the Promissory Note is outstanding, and, while her voting rights will diminish over time, she will: (a) continue to have information rights; (b) will continue to be bound by and the beneficiary of the fiduciary obligations of the other members and managers (if any); (c) if provided for in the applicable limited liability company act, will remain capable of initiating a derivative action on behalf of or a dissolution action against the limited liability company; and (d) will remain bound by the balance of the Operating Agreement. At first blush, this option may appear most advantageous to the Redeemed Member. Pursuant to the Promissory Note she has the rights of either a general or a secured creditor. At the same time, she continues to enjoy the benefits of the Operating Agreement. However, as she remains a member and bound by the Operating Agreement, she may be constrained by fiduciary obligations that could preclude engaging in activities competitive with the Company and perhaps has an obligation to deliver to the Company business opportunities of which she becomes aware.

(iv) until such time as the Promissory Note is satisfied in full, the Redeemed Member {shall continue to have the rights of a Member under Articles __, __, and __ of the Operating Agreement} {shall have the following rights as if a Member of the Company:

(A) to inspect Company reports {as provided in Article __ of the Operating Agreement}[26] {as provided in (cite applicable statute)}[27] {as provided in Article __ of the Operating Agreement and (cite applicable statute)};[28]

(B) to {vote as a Member on any vote of the Members to dissolve the Company}[29] {exercise a veto against any voluntary dissolution of the Company};[30]

(C) to initiate an action under (cite applicable statute) for the judicial dissolution of the Company;[31] or

(D) _____.}[32]

3. Other Consideration for Redeemed Member's Interest[33]

There follow five alternative provisions

As further consideration for the Interest, the Company has caused the personal guarantee of the Redeemed Member to Friendly National Bank, N.A. given

26. Used if the operating agreement contains a comprehensive provision on inspection rights that entirely supersedes the underlying limited liability company act.

27. Used if the operating agreement (i) is silent as to inspection rights and those rights are determined by reference to the underlying limited liability company Act or (ii) while the operating agreement has provisions on the inspection rights of the members, the Redeemed Member is to have only the rights afforded by the statute.

28. Used if the operating agreement contains a provision modifying, but not entirely superseding, the underlying limited liability company act.

29. Being no longer a Member, the Redeemed Member, although receiving continuing payments from the Company, will not normally have the right to vote on the dissolution, or on any organic transaction such as a merger or conversion, of the Company. *See Landskroner*, *supra* note 24. This provision preserves her right to vote on a proposed dissolution. The drafter should consider what other types of transaction, such as merger or conversion, should give rise to this right. The drafter must also address how the Redeemed Member's relative voting power will be determined.

30. Unlike the preceding option, which provided for participation in the decision, this language gives the Redeemed Member a veto right over any proposed dissolution.

31. This provision assumes the controlling limited liability company act permits the allocation of this power to a non-member.

32. Under this option, the Redeemed Member will cease to be a member at the time the initial payment is delivered. Her rights vis-à-vis the Company are thereafter governed by the Agreement and the Promissory Note. However, unlike the penultimate option, she will either retain rights under portions, but not all, of the operating agreement, in which case the operating agreement must be referenced to ascertain her rights, or be afforded certain "pseudo-member" rights as set forth in the Agreement. The rights set forth in (A) through (C) are only examples, and the rights afforded the Redeemed Member will be a matter of negotiation.

33. This section assumes that the Redemption Consideration is more than the Redemption Price.

with respect to the term indebtedness described on *Exhibit 3* to be released in full.[34]

– or –

As further consideration for the Interest, the Company has caused the personal guarantee of the Redeemed Member to Stingy National Bank, N.A. given with respect to the line of credit described on *Exhibit 3* hereto to apply only to indebtedness of {$_____} {the amount of indebtedness as of the Effective Time}.

– or –

[add provision by which the Company will indemnify Redeemed Member from exposure to bank debt or other personally guaranteed obligation].[35]

– or –

Except with respect to the indebtedness described on *Exhibit 3*, notwithstanding any provision of this Agreement to the contrary, the Redeemed Member shall be and remain bound by and a beneficiary of Article X of the Operating Agreement with respect to all Company indebtedness for which the Redeemed Member may have personal liability.[36]

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34. A member, notwithstanding the limited liability afforded members by all of the limited liability company acts, may have: (i) undertaken contractual obligations to third parties, a guarantee of limited liability company bank indebtedness being a classic example; and/or (ii) common law liabilities to other members arising from obligations of contribution or indemnification; and/or (iii) statutory liability for certain obligations of the limited liability company. *See also supra* note 21. The termination of the Redeemed Member's participation in the Company will often not terminate those liabilities. Counsel to the Redeemed Member will need to identify those liabilities and address them in some combination of releases, indemnification, and/or adjustments to the Redemption Price. *See also* Haley v. Talcott, 864 A. 2d 86 (Del. Ch. 2004) (exit mechanism in operating agreement not enforced as it did not provide for withdrawing member's release from guarantee of limited liability company's bank debt). If Company debt was guaranteed by a Redeemed Member and if such guarantee caused all or a portion of that debt to be allocated to the Redeemed Member for purposes of Code § 752, then the release of that guarantee will cause the Redeemed Member to receive a constructive cash distribution equal to the portion of that debt so allocated to the Redeemed Member. For tax purposes, this constructive cash distribution will generally be treated as additional purchase price paid for the Redeemed Member's Interest.

35. Counsel to Redeemed Member may want this Company obligation personally guaranteed by the Remaining Members.

36. For purposes of this provision, it is assumed that Article X of the Operating Agreement provides, *inter alia*, that the members have contribution obligations among themselves to the extent that any member is obligated to perform on a guarantee of a debt in favor of the limited liability company. This version of Section 3 allows the Redeemed Member to remain a beneficiary of, while still being bound by, that contribution obligation. *See*, *e.g.*, Volinote v. Ballis, 295 F.3d 666 (7th Cir. 2002) (former member, held liable on personal guarantee of the limited liability company's bank indebtedness, was not able to secure indemnification from current member because although operating agreement provided for cross-indemnification among members for guarantees, because this provision was held not to benefit a former member). Counsel to the Redeemed Member should consider how to protect the Redeemed Member from a post-closing modification of Article X.

– or –

(other).[37]

4. Adjustments to Redemption Consideration[38]

There follow three alternative provisions

The Redemption Consideration is not subject to adjustment.

– or –

Adjustment to Redemption Consideration in the Event of a Change of Control Transaction.[39]

37. All possible options cannot be recited here. For example, the limited liability company could transfer other real or personal property to the Redeemed Member, afford her an option to acquire company property in the future, or agree to not compete with her new venture.

38. Section 4 addresses whether and in what circumstances the Redemption Consideration is subject to adjustment, post closing, either higher or lower, to account for matters not known at the time of closing but for which the parties to the Agreement seek to account. There is no obligation that the Redemption Consideration be subject to a post-closing adjustment. Practices vary regarding whether it is necessary or appropriate to state expressly that no post-closing adjustment is contemplated. If the Redemption Price is the sole consideration for the redemption, and there is no other transfer of value necessitating a distinction between the "Redemption Price" and the "Redemption Consideration," the latter term should not be used in the agreement and this Section 4 should be revised to address the adjustment of the Purchase Price.

39. This provision serves to protect the Company and those in control of it from a charge of manipulation of the redemption in anticipation of a possible sale of the Company not previously disclosed to the Redeemed Member. Numerous cases point out the need for full disclosure by the entity in the course of negotiating/implementing a redemption. For example, in *Lawton v. Nyman*, 327 F.3d 30 (1st Cir. 2003), the court found that certain corporate directors/officers violated their fiduciary obligations to non-controlling shareholders who were redeemed without being advised of a possible sale of the corporation. *Anderson v. Wilder*, No. E2003-00460-COA-R3-CV, 2003 WL 22768666 (Tenn. Ct. App. Nov. 21, 2003), involved allegations that the controlling members of a limited liability company violated their fiduciary obligations to the minority by triggering an expulsion provision in the operating agreement at a redemption price of $150 per unit and then selling a minority position in the limited liability company for $250 per unit. *Blue Chip Emerald LLC v. Allied Partners, Inc.*, 750 N.Y.S. 2d 291 (N.Y. App. Div. 2002), found a breach of fiduciary duty where a 50% member was redeemed based on a $80 million valuation and the LLC's sole asset was two weeks later sold for $200 million. *Salm v. Feldstein*, 799 N.Y.S. 2d 104 (N.Y. App. Div. 2005), in which it was held a managing member owed co-member fiduciary duty to make full disclosure of all material facts, disclaimer in redemption/settlement agreement pursuant to which managing member bought out co-member did not waive duty, and fact issues existed regarding sufficiency of disclosure in connection with sale of limited liability company's business two days after purchase by managing member of co-member's interest. *Contrast Ledford v. Smith*, 618 S.E.2d 627 (Ga. Ct. App. 2005), in which it was held that active members of limited liability company did not have contractual duty to other member to disclose, and did not breach a fiduciary duty to other member by failing to disclose, that their buy-out offer under mandatory put-call provision of operating agreement was being financed by a third party that had agreed to buy the limited liability company's assets after the buy-out was closed, relying in part on freedom to restrict and eliminate fiduciary duties under Georgia Limited Liability Company Act and clause in operating agreement permitting members to engage in other activities so long as they did not compete with limited liability company.

(1) If the Company becomes the subject of a Change of Control Transaction at any time within {180 days} {1 year} {other defined period} following the Effective Time, the Company shall promptly give notice to the Redeemed Member that sets forth the terms and conditions of the Change of Control Transaction. The Company shall promptly give supplemental notice to the Redeemed Member of any material changes to those terms and conditions.

(2) The Redeemed Member (and the Redeemed Member's agent or attorney) shall have the right to inspect and copy, during regular business hours at the Company's principal office, all documents the execution or delivery of which are necessary to effectuate the Change of Control Transaction. All notices given and documents inspected or copied pursuant to this Section shall be treated as confidential information of the Company subject to Section 12 hereof.

(3) Promptly following the consummation of the Change of Control Transaction, the Company shall pay the Redeemed Member an amount equal to the fair market value of the Interest as of the Effective Time (after taking into account the existence of the Change of Control Transaction had the proposed Change of Control Transaction been known at that time) less the {market value}{fair market value}[40] of the Redemption Consideration. The payment must be accompanied by an explanation of how the amount thereof was calculated (the "Payment Notice").

(4) The Redeemed Member may return, or otherwise refuse to accept, this payment, notify the Company in writing of the Redeemed Member's own calculation of the amount (which shall include an explanation of how that amount was calculated), and demand payment thereof (the "Demand Notice"). The Company may elect to pay the amount set forth in the Demand Notice within 30 days and, if the Company fails to make such election, either party may submit the calculation to arbitration pursuant to Section 14(h).

(5) The Redeemed Member waives the right to demand additional payment if a Demand Notice is not given to the Company within thirty (30) days following the giving of the Payment Notice.

(6) This Section 4 provides the exclusive remedy available to the Redeemed Member upon the occurrence of a Change of Control Transaction following the Effective Time.

– or –

Adjustment to Redemption Consideration in the Event of Unanticipated Allocation of Taxable Income.

(1) The Redeemed Member has been provided copies of the Company's federal income tax returns for the {two taxable years} {three taxable years} {other period} preceding the Effective Time (the "Previous Years").[41] The Redemption Price has been determined based upon the assumption that the

40. Be aware of distinctions between market value and fair market value.

41. Consider whether this defined term should be moved to the table of definitions in Section 1.

Redeemed Member's share of income and gain for the Previous Years will be determined based on the information returns filed by the Company and the assumption that the Redeemed Member will be allocated net income and gain of the Company (determined without regard to any income or gain recognized by the Redeemed Member as a result of actual or constructive distributions under Code § 731)[42] not to exceed $_____ for the year in which the Effective Time occurs (the "Current Year").[43]

(2) To the extent that any combination of: (i) any increase in the Redeemed Member's net income or gain resulting from a re-determination of such net income or gain for the Previous Years and (ii) the Redeemed Member's share of net income or gain for the Current Year exceeds $_____, the Company shall, in addition to the Redemption Price set forth above, pay to the Redeemed Member an amount equal to ___% of such excess by wire transfer of immediately available federal funds pursuant to the instructions provided by the Redeemed Member within thirty (30) days of the determination of such excess.[44]

5. Representations and Warranties of the Company[45]

Effective as of the date of this Agreement and as of the Closing Date, the Company represents and warrants to the Redeemed Member as follows:

42. While a member may incur tax liability with respect to distributions of cash or a reduction in the member's share of Company liabilities, this language is intended to ensure that the Redeemed Member rather than the Company bears the tax obligations resulting from the distribution. The Company and the Redeemed Member should each consult Code § 706(c)(2)(A) with regard to the closure of the Company's tax year with respect to a member who completely redeems her interest. Code § 706(c)(2)(B) provides that the Company's tax year does not close with respect to a Member whose interest is reduced without being terminated. Code § 706(d) provides a series of rules for determining a Member's distributive share of limited liability company income when such Member's interest changes during the Company's tax year. It is assumed that the Redeemed Member's Interest is less than 50% of the total interests in the Company. Still, the redemption, as contrasted with the transfer, of 50% or more of the interests will not trigger a Code § 708(b) termination of the tax partnership. Treas. Reg. § 1.708-1(b)(1)(ii) (codified at 26 C.F.R. § 1.708-1(b)(1)(ii) (2005)).

43. Consider whether this defined term should be moved to the table of definitions in Section 1.

44. The Redeemed Member, as a partner for tax purposes, may be allocated income, loss, deductions, and credits for the year of dissociation. This provision does not address deductions and losses (except to base payment on the "net" income and gain). Note as well that income allocation increases basis and hence reduces gain on redemption. Like tax distribution provisions generally, provisions of this type may be quite complex. It is included in this Model Agreement to remind the drafter that this issue should be considered. The Redeemed Member may seek to negotiate for a right of consent to the amendment of the prior year tax returns.

45. Consideration needs to be given to whether the Remaining Members will make any representations and warranties, make all representations and warranties jointly with the Company, or make separate representations and warranties. In a limited liability company involving only a few members, all of whom are involved in day-to-day management, the Redeemed Member can make an easier case that the Remaining Members should participate in the representations and warranties than would be the case in a large limited liability company in which there are a significant number of passive members.

(a) the Redeemed Member is not in default or breach of the Operating Agreement;[46]

(b) the Redeemed Member is not under any current or future obligation to contribute capital to the Company;[47]

(c) this Agreement shall not result in the breach of any other agreement to which the Company is a party;[48]

(d) the Company has obtained all requisite and necessary consents, approvals, or other assurances for it to enter into this Agreement including, without limitation, the consent required under any other agreement to which it is a party;[49]

(e) the Company is duly formed, validly existing, and in good standing under {the laws of its jurisdiction of formation}{the Act} and is duly authorized and qualified to do all things required of it under this Agreement and any agreement executed in connection with the transactions herein contemplated;

(f) all tax returns and information returns required to be filed by the Company have been accurately prepared in all material respects and timely filed and all taxes for which the Company may be held liable (including, but not limited to employment tax returns, sales tax returns, excise tax returns, and any other returns due to federal, state, local or foreign taxing authorities) have been paid or accrued within the prescribed period or any extension thereof;

(g) the Company is repurchasing the Redeemed Member's Interest for its own account and not on behalf of any other person;[50] and

(h) to the best of its knowledge, there is no outstanding litigation or other proceeding existing or threatened with respect to the Company or any other matter concerning the Company.[51]

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46. Counsel to the Redeemed Member will want to protect her, perhaps by means of a release, from a post-closing allegation of a prior default or breach of the operating agreement that if proven would necessitate a return of some or all of the Redemption Consideration and potentially the assumption of other obligations to the limited liability company.

47. Most limited liability company acts provide that an obligation to contribute capital to the limited liability company will remain enforceable against the member even if the membership interest is assigned (*see*, *e.g.*, KY. REV. STAT. ANN. § 275.255(1)(f) (LexisNexis 2003); TEX. BUS. ORGS. CODE § 101.111(b) (Vernon 2005)) or notwithstanding "the member's death or disability or any other reasons." FLA. STAT. ANN.§ 608.4211(2) (West 2001 & Supp. 2006); TEX. BUS. ORGS. CODE § 101.152 (Vernon 2005); ReULLCA § 403(a). The statutes do not address the continuation of a contribution obligation subsequent to a redemption. A failure to expressly address the absence of a contribution obligation could lead to a situation in which an obligation is claimed that will offset some or all of the Redemption Consideration.

48. Consider, for example, debt covenants limiting or forbidding the limited liability company from making a distribution and/or redeeming a member's interest.

49. Certain limited liability company acts, such as those of Delaware and Florida, provide specific authority for the redemption of a member's interest in the limited liability company. *See* DEL. CODE ANN. tit. 6, § 18-702(e) (2005); FLA. STAT. ANN. § 608.432(5) (West 2001 & Supp. 2006). Other limited liability company acts are silent on the matter, and no limited liability company act forbids a redemption. If the limited liability company's operating agreement prohibits a redemption, all of the Remaining Members, or such lower threshold as is required for amendment of the operating agreement, will need to either join the Agreement as parties or execute a consent approving of the Agreement and in effect so amending the operating agreement. If a separate consent is used, consider whether it should be an exhibit to the Agreement.

50. This representation may affect the availability of exemptions from registration under federal or state securities law.

51. This representation benefits the Redeemed Member in that it may protect the Redeemed Mem-

6. Representations and Warranties of the Redeemed Member

The Redeemed Member represents and warrants to the Company as follows:

(a) she is the sole owner of the Interest, has not transferred any portion of the Interest, holds the Interest free and clear of all claims and encumbrances, and has the power and authority to transfer the Interest;[52]

(b) [it is duly formed, validly existing, and in good standing under the laws of its jurisdiction of formation and is duly authorized and qualified to do all things required of it under this Agreement and any agreement executed in connection with the transactions herein contemplated;][53]

(c) she is not a "foreign person" within the meaning of Code § 1445 and will furnish the Company with an affidavit that satisfies the requirements of Code § 1445(b)(2) in the form attached as *Exhibit 6(c)*;[54] and

(d) she is not a party to litigation or any similar proceeding in which a charging order against the Interest has been sought or awarded.[55]

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ber from being charged with participating in a fraudulent conveyance or other improper distribution in light of a potential adverse judgment or decision. An alternative formulation of this representation appears at section 3.18 of the Model Stock Purchase Agreement. Model Stock Purchase Agreement with Commentary (ABA 1995).

52. Interests in a limited liability company are general intangibles and payment intangibles governed by Article 9 of the Uniform Commercial Code. The interests may be certificated and the limited liability company may elect that thereafter the interests are governed by Article 8 of the Uniform Commercial Code. *See generally* Lynn A. Soukup, *"Opting In" to Article 8—LLC, GP & LP Interests as Collateral*, *Commercial Law Newsletter* (newsletter of the ABA Uniform Commercial Code Committee), July, 2002, *reprinted in PUBOGRAM* (newsletter of the ABA Committee on Partnerships and Unincorporated Business Organizations), November, 2002. *See also* Robert R. Keatinge, *Taking and Enforcing Security Interests in Interests in Unincorporated Businesses*, Limited Liability Entities in Time of Change, ALI-ABA (March 12, 2002), available on Westlaw at VPC0312 ALI-ABA 245; Robert R. Keatinge, *Interests in Unincorporated Associations as Securities Under Article 8 of the UCC,* Limited Liability Entities in Times of Change, ALI-ABA (March 12, 2002), available on Westlaw at WPC0312 ALI-ABA 361. Counsel to each of the Company and the Redeemed Member will need to determine which paradigm controls and then investigate any pledge of or other security interest in the Interest.

53. This representation and warranty will be used only if the Redeemed Member is an entity and not a natural person.

54. This affidavit will not be required if the Company does not own real estate. The regulations under Code § 1445 are not a model of clarity as to whether this affidavit is necessary if the Company owns real estate but does not dispose of it as part of the redemption either through sale or through distribution. However, the redemption of a membership interest in a Company that owns real estate seems to be consistent with the type of transaction that the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA"), Pub. L. No. 96-499, Title XI, Subchapter C, 94 Stat. 2599, 2682, was intended to reach. Accordingly, securing the affidavit in such circumstances is recommended.

55. The Company will want to know that no charging order is in place so as to protect itself from a claim that it is making an improper distribution to the Redeemed Member rather than to her judgment creditor. As to the action in which a charging order has been sought, but not yet awarded, against the Redeemed Member, there exists no order that could be inadvertently violated. The representation protects the Company by demonstrating due diligence.

7. Solvency of the Company

{The Company represents to the Redeemed Member} {Each of the Company and the Redeemed Member[56] agree that}:

(a) the assets of the Company exceed its current liabilities; and

(b) the Company is able to meet its debts and obligations as they come due in the ordinary course of business,[57] which determination is based upon a review of the Company's financial records[58] as of the Effective Time.[59]

8. Mutual Release

As of the Effective Time and except as with respect to representations, warranties, indemnities, and covenants contained in this Agreement:

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56. Whether the Redeemed Member should join in this representation will depend on her degree of involvement in the operation of the limited liability company.

57. Almost all limited liability company acts provide that the limited liability company may not make a distribution to a member if after doing so the limited liability company would not be able to pay its debts as they come due in the ordinary course or if the limited liability company would have liabilities exceeding its assets. *See*, *e.g.*, Ky. Rev. Stat. Ann. § 275.225(1) (LexisNexis 2003); Del. Code Ann. tit. 6 § 18-607(a) (2005); Fla. Stat. Ann.§ 608.426(2) (West 2001); Tex. Bus. Orgs. Code § 101.206 (Vernon 2005); Va. Code Ann. § 13.1-1035(A) (1999 & Supp. 2005); ULLCA §§ 406(a)(1), 406(a)(2); ReULLCA §§ 405(1), 405(2). These provisions often track MBCA § 6.40(c). An exception is Maryland, which addresses improper distributions through its fraudulent conveyance statute. *See* Md. Code Comm. Law § 15-208(b)(1) (2000). A redemption will in most, if not all, instances be governed by the same limitations. *See also* ULLCA § 406(c)(1) (discussing a "redemption" in the context of a distribution). A review of the financial records and an express determination of solvency demonstrate due diligence and may preclude a claim that the distribution should be recovered from the recipient or an equal amount from those who approved the distribution (*see*, *e.g.*, Ky. Rev. Stat. Ann. § 275.230 (LexisNexis 2003); Del. Code Ann. tit. 6 §§ 18-607(b), 18-607(c) (2005); Fla. Stat. Ann. § 608.426(3)-(5) (West 2001 & Supp. 2006); Va. Code Ann. § 13.1-1036 (1999); Prototype §§ 407(a), 407(b)) or liability under fraudulent conveyance/transfer law.

58. To determine whether a distribution is proper, many limited liability company acts provide that reference may be made to and the determination may be based upon "financial statements prepared on the basis of accounting practices and principals that are reasonable under the circumstances" as well as "fair valuations" of assets and liabilities. *See*, *e.g.*, Ky. Rev. Stat. Ann. § 275.225(2) (LexisNexis 2003); Fla. Stat. Ann. § 608.426(2) (West 2001); Va. Code Ann. § 13.1-1035(B) (1999 & Supp. 2005); ULLCA § 406(b); ReULLCA § 405(b). *See also* MBCA § 6.40(c), ULPA § 508(c). As with many provisions of this Model Agreement, the language of the agreement needs to be customized to conform to the controlling limited liability company act. Note, however, that neither the statutes nor the case law are clear as to the preclusive effect of reliance on those records.

59. Tracking MBCA § 6.40(e), many limited liability company acts provide for when the effect of a distribution, including a redemption payout, should be measured in assessing the solvency of the limited liability company. *See*, *e.g.*, Ky. Rev. Stat. Ann. § 275.225(3) (LexisNexis 2003); Va. Code Ann. § 13.1-1035(C) (1999 & Supp. 2005); ULLCA § 406(c); ReULLCA § 405(c). Other states, an example being Florida, include such a provision in the corporation act (Fla. Stat. Ann. § 607.06401(6) (West 2001)) but do not include one in the LLC act. Curiously, Florida incorporates such a limitation for payments made by an LLC under the dissenter rights provision of its LLC act. Fla. Stat. Ann. § 608.43595(1) (West Supp. 2006). If payments are made over time, particular attention needs to be paid to the continuing assessment of the impact upon solvency. Counsel to the Redeemed Member should consider that a change in circumstances could preclude the Company from performing upon a future obligation to make payments by (a) properly counseling his/her client on that eventuality, (b) seeking protections for the Redeemed Member such as a guarantee of performance from some or all of the Remaining Members and/or other security for performance such as a secured promissory note, and/or (c) structuring the payment obligations so that it is senior to and guaranteed before any distributions may be made to the Remaining Members.

(a) Each of the Company and the Remaining Members (collectively with any of their heirs, executors, administrators, personal representatives, successors, and assigns, for purposes of this Section 8(a), the "Releasor") releases the Redeemed Member and any Affiliate thereof (each, for purposes of this Section 8(a), an "Exculpated Party") from any and all Claims that Releasor ever had, now has or hereafter can, shall, or may have against any Exculpated Party for, upon, or by reason of: (i) any matter, cause, or thing whatsoever from the beginning of the world to the date of this Agreement; and (ii) any matter, cause or thing whatsoever which arises from and after the date of this Agreement, including, without limitation, any matter or thing arising from or in connection with the Operating Agreement or any transaction entered into by the Company.

(b) The Redeemed Member and any Affiliate thereof (collectively with any of their heirs, executors, administrators, personal representatives, successors, and assigns, being for purposes of this Section 8(b), the "Releasor") releases each of the Company and the Remaining Members, their respective officers, directors, shareholders, members, managers, beneficial owners, trustees, partners, affiliates, employees, participants, and agents (each, for purposes of this Section 8(b) an "Exculpated Party") from all Claims that Releasor ever had, now has or hereafter can, shall, or may have against any Exculpated Party for, upon, or by reason of: (i) any matter, cause, or thing whatsoever from the beginning of the world to the date of this Agreement, and (ii) any matter, cause or thing whatsoever which arises from and after the date of this Agreement, including, without limitation, any matter or thing arising from or in connection with the Operating Agreement or any transaction entered into by the Company.

9. Indemnification

Effective as of the Effective Time:

(a) *Company Indemnification.* The Company shall indemnify and hold Redeemed Member harmless from any and all Claims arising, directly or indirectly, out of or resulting from: (i) the operation of the Company from the Effective Time forward; (ii) any matter arising from or in connection with the Operating Agreement from the Effective Time forward; (iii) any transaction entered into by the Company from the Effective Time forward; (iv) any breach by the Company of a covenant or obligation in this Agreement; (v) any liability arising out of the ownership and/or operation of the Interest from the Effective Time forward; and (vi) any breach or inaccuracy of any representation or warranty by the Company contained in this Agreement.[60]

(b) *Redeemed Member's Indemnification.* The Redeemed Member shall indemnify and hold the Company harmless from any and all Claims or diminution of

60. Specific indemnification provisions should be tailored to each agreement because each agreement has its own individual and specific business risk and liability profile. The extent of an indemnification provision depends on the circumstances of each agreement and is generally going to be subject to negotiation between the Redeemed Member, the Company and perhaps the Remaining Members.

value, whether by third party claim[61] or otherwise arising, directly or indirectly, out of or resulting from: (i) any matter arising from or in connection with a violation by the Redeemed Member of the Operating Agreement prior to the Effective Time; (ii) any breach by the Redeemed Member of a covenant or obligation in this Agreement by the Redeemed Member; and (iii) any breach or inaccuracy of any representation or warranty by the Redeemed Member contained in this Agreement. [The remedies provided in this Section 9(b) shall be the exclusive and sole remedies for any and all claims relating to this Agreement.][62]

[9(c) through 9(e) are optional provisions]

(c) *Company and Remaining Members' Indemnification Basket.* The Company shall not have any liability with respect to any or all the matters described in Sections 9(a)(i) through (v) until the aggregate amount of all such damages arising out of those Sections exceeds _____ Dollars ($_____), and then only for the amount by which such damages exceed _____ Dollars ($_____). However, this Section 9(c) shall not apply to the Company indemnification of any breach in accordance with Section 9(a)(vi) above, and the Company shall remain liable for any and all damages with respect to such breach of Section 9(a)(vi).[63]

(d) *Redeemed Member's Indemnification Basket.* A Redeemed Member shall not have any liability with respect to matters described in Section 9(b)(i) or 9(b)(ii) until the aggregate amount of the damages arising out of those Sections exceeds _____ Dollars ($_____), and then only for the amount by which such damages exceed _____ Dollars ($_____). However, this Section 9(d) shall not apply to the Redeemed Member's indemnification of any breach in accordance with Section 9(b)(iii) above and the Redeemed Member shall remain liable for any and all damages with respect to such breach of Section 9(b)(iii).[64]

(e) *Right of Setoff.* The Company may set off any amount to which the Redeemed Member may be entitled under this Section 9 against the remaining amount of the {Redemption Price} {Redemption Consideration} in accordance

61. Inserting language that a third party claim is not required for a Redeemed Member to enjoy indemnification solidifies the parties' intent that indemnifiable damages do not require a third party claim.

62. Unless there is a specific provision stating that the remedies provided in the indemnification provision shall be the exclusive and sole remedies for all claims, subject to contrary state law, the Redeemed Member also may have causes of action based on breach of contract, fraud and misrepresentation, federal securities law and other federal and state statutory claims. As presented, this provision is heavily weighted in favor of the Company and Remaining Members, and counsel for the Redeemed Member may want to seek removal of this provision. However, if this provision remains, please be aware that liability arising under federal securities law cannot be waived.

63. This provision is based upon section 10.7 of the Model Stock Purchase Agreement. MODEL STOCK PURCHASE AGREEMENT WITH COMMENTARY (ABA 1995). For a discussion of indemnification baskets or similar treatments, see Section 10.7 of the Model Stock Purchase Agreement.

64. This provision is based upon section 10.6 of the Model Stock Purchase Agreement. For a more in depth discussion on indemnification baskets as to the Redeemed Member, see section 10.6 of the Model Stock Purchase Agreement.

with Section 9(c) above, upon twenty (20) days' written notice to the Redeemed Member before the next payment of the {Redemption Price} {Redemption Consideration}. The exercise of such right of setoff by the Company, whether such setoff is ultimately determined to be unjustified, will not constitute an event of default under any Promissory Note.[65]

(f) *Procedure.* A party entitled to indemnification ("Indemnified Party") by the provisions of Section 9(a) or 9(b) shall be indemnified for the amount of any liability, loss, claim damages, costs and expenses, including court costs and reasonable attorneys' fees arising from a breach by the indemnifying party ("Indemnitor") subject to indemnification pursuant to this Section 9 within twenty (20) days after receipt of notice of such liability, specifying the amount of such liability and the breach which is subject to indemnification hereunder.[66]

10. Income Tax Matters

(a) The {Redemption Price} {Redemption Consideration} shall be treated as paid for the Interest in Company tangible property under Code § 736(b)(1) only to the extent of the fair market value thereof as set forth on *Exhibit 10(a)*. The entire balance of the {Redemption Price} {Redemption Consideration}, including without limitation any portion attributable to the Interest in unrealized receivables and any intangible assets, and any interest or any promissory note given in partial payment of the {Redemption Price} {Redemption Consideration}, shall be treated as guaranteed payments as described in Code § 736(a)(2).[67]

65. This provision to provide a setoff applies only if the Redemption Consideration includes the Promissory Note pursuant to which portions of the Redemption Consideration will be paid over time. If there were an agreement to place a portion of the Redemption Consideration in escrow for a certain amount of time, and if there is any amount due to the Company as a result of the indemnification provisions, the Company may have it paid to the Company by the escrow agent.

66. The procedure outlined in Section 9(f) does not deal with the procedure for a third party claim in which the indemnifying party would have some role in the defense of the claim. For a good model of that type of indemnification procedure, see section 10.9 of the Model Stock Purchase Agreement and its accompanying commentary.

67. Under Code § 736, payments in liquidation of a member's interest fall into two categories: (1) payments for the member's interest in limited liability company property (Code § 736(b)); and (2) payments which are not in exchange for limited liability company property (Code § 736(a)). Code § 736(a) payments are further subdivided into two categories: (x) those determined "with regard to the income of the [limited liability company]," which are treated as a distributive share of limited liability company income, and (y) those determined "without regard to the income of the [limited liability company]," which are treated as "guaranteed payments" under Code § 707(c). Generally, payments made in liquidation of the interest of a retiring member are treated as made in exchange for the interest of such member in limited liability company property, rather than as an allocation of income or as a guaranteed payment. *See* Code § 736(b)(1); *see also* Steven G. Frost and Sheldon I. Banoff, *Square Peg, Meet Black Hole: Uncertain Tax Consequences of Third Generation LLEs*, 100 J. Tax'n 326, 336 (June 2004). However, payments in exchange for an interest in limited liability company property do not include amounts paid for unrealized receivables or goodwill of a "partnership" except to the extent a "partnership" agreement provides for payment with respect to goodwill. *See* Code § 736(b)(2). However, this exception for unrealized receivables and goodwill applies only if capital is not a material income-producing factor for the partnership, and the Redeemed Member was a "general partner" in the "partnership." *See* Code § 736(b)(3). Capital is not deemed to be a material income-producing factor in firms providing health, law, engineering, architecture, accounting, actuarial science, or consulting services. Thus, the potential treatment of the payments for goodwill to be taxed

(b) Notwithstanding any other provision of this Agreement, the Redeemed Member shall have the right to receive information in connection with the Company's tax returns necessary for the Redeemed Member to protect the Redeemed Member's interest and comply with law and regulations.[68]

11. Withdrawal and Resignation

As of the Closing, the Redeemed Member withdraws[69] as and ceases to be a Member[70] and resigns all positions in the Company as a manager, officer or other agent of the Company, and the Company accepts the withdrawal and resignation.[71]

12. Confidentiality and Competition

(a) The Redeemed Member acknowledges that information (including but not limited to customer lists, trade secrets, and operational information such as budgets)[72] she received as a Member of the Company is and continues to be Company property, and agrees not to disclose or use the information in any manner that competes with or is injurious to the Company.

– or –

as capital gain (if the operating agreement properly provides for goodwill payments) or ordinary income (if the operating agreement does not so provide) is generally limited to general partners retiring from service partnerships. Otherwise, payments for a retiring partner's share of goodwill produce capital gain. It is unclear whether a member of an limited liability company can ever be a general partner for purposes of this test. Payments for a retiring member's share of "unrealized receivables" (as defined in Code § 751(c)) produce ordinary income to the retiring member whether or not she is treated for tax purposes as a general partner in a partnership in which capital is a material income-producing factor. For an excellent discussion of this issue, *see* Frost and Banoff, *supra*; *see also* McKee, Nelson & Whitmire, *supra* note 22, at chapter 22.

68. For tax purposes, the Redeemed Member may be treated as a continuing partner until the Company has made all payments to her. Treas. Reg. §1.736-1(a)(6) (codified at 26 C.F.R. § 1.736-1(a)(6) (2005)). It is not uncommon for a redeemed member's interest to be liquidated in a series of payments over more than one year, a procedure that is beneficial to the Company's cash flow and benefits the Redeemed Member with installment sales treatment under Code § 453. Since, in such case, the Redeemed Member may continue to be a partner for tax purposes, she would be well advised to continue to retain the same rights to Company tax information that she had prior to executing this Agreement. Even if the Redeemed Member's interest is liquidated in the year in which she executes the redemption agreement, she will still have an interest in the amount and character of income allocated to her through the date of the redemption, as well as the tax treatment under Code § 736 of any liquidating payments to her. Accordingly, she would be well advised to negotiate for this provision (or something similar to it).

69. The Delaware LLC Act, at § 18-603 (Del. Code Ann. tit. 6 § 18-603 (2005)), and the Virginia LLC Act, at § 13.1-1032 (Va. Code Ann. § 13.1-1032 (1999)), speak of a member "resigning," not "withdrawing," from the limited liability company. In contrast, the Prototype, at § 802(A)(1), and the Texas Statute, at § 101.107 (Texas Bus. Orgs. Code Ann. § 101.107 (Vernon 2005)) speak of a member "withdrawing." The terminology employed should conform to the controlling statute and operating agreement.

70. Not applicable if the third option of Section 2(e) is employed.

71. While this may seem obvious, it is useful to confirm that the Redeemed Member has relinquished any offices and/or agency authority she may have held.

72. Conform language to particular issues of the limited liability company at issue.

(a) The Redeemed Member agrees to remain bound by Article ___ of the Operating Agreement [for a period of _____ after the date of this Agreement] [for the term of the Company].[73]

(b) The Redeemed Member agrees to hold in trust for the Company any profits or gains obtained directly or indirectly from the use of such information and to account to the Company for such profit and gain.[74]

– or –

(a) *Access to Confidential Information.* The parties acknowledge and recognize that by reason of the Redeemed Member's prior relationship with the Company, the Redeemed Member has knowledge of financial information, methods of doing business, books, records and the customer lists of the Company[75] (collectively, the "Confidential Information"), which have not otherwise been publicly distributed and is not, in any manner, common knowledge. The Redeemed Member shall not, at any time, divulge or reveal any of the Confidential Information to any person, Affiliate, party or entity, directly or indirectly, or utilize any of the Confidential Information for the Redeemed Member's benefit or for the benefit of any other Affiliate, person, party or entity, except with the prior written consent of the Company.

(b) *Return of Confidential Information, Documents, Etc.* In recognition of the sensitive nature of the Confidential Information, the Redeemed Member shall immediately return to the Company, or destroy, all of the Confidential Information provided to the Redeemed Member by the Company including, but not limited to, all memoranda, records, files, other documents or any other materials in the Redeemed Member's possession as comprised of and relating to the Confidential Information, including any photocopies, electronic copies, faxes, emails or other reproductions made by the Redeemed Member.

(c) *Covenant Not to Compete.* The Company recognizes that by reason of her prior relationship with the Company, the Redeemed Member has knowledge of the Confidential Information. Accordingly, the Redeemed Member covenants and agrees with the Company and the Remaining Members that for a period of two (2) years from and after the Closing Date, the Redeemed Member nor any Affiliate shall engage directly or indirectly in any manner or capacity or advance or lend any money to, or make or hold any investment in any person or entity which is in the business of the Company within a _____ (____) mile radius of the address of the Company as detailed in *Exhibit 12(c)* (this "Covenant Not to Compete").[76]

73. This provision is premised on a comprehensive confidentiality provision in the operating agreement that binds current, but not former, members.

74. This provision should be tailored to specific trade secret and competition rules and describe the nature of the limited liability company's business. If the operating agreement adequately covers competition and trade secrets, it may be more appropriate to simply agree that those provisions will continue to bind the Redeemed Member for an agreed upon period of time.

75. Consider whether should include as well confidential information of customers and/or other third parties.

76. Consider limits of controlling law.

Notwithstanding the foregoing, if the Company becomes aware of a violation by the Redeemed Member or any Affiliate of the provisions of this Section 12(c), the Company shall notify the Redeemed Member in writing of such violation whereby upon the receipt of such notice in accordance with *Exhibit 12(c)*, the Redeemed Member and any Affiliate shall cease any such violation of the provisions of this Section 12(c), as set forth in such written notice immediately. If the Company has notified the Redeemed Member of a violation of this Section 12(c), and the Redeemed Member or any Affiliate continue to violate this Section 12c) following the giving of notice by the Company to the Redeemed Member, or if the Redeemed Member or any Affiliate commits any subsequent violation of this Section 12(c), the Company shall not be required to give any further or subsequent notice to the Redeemed Member of any continuing violation or of further or subsequent violation of this Section 12(c) by the Redeemed Member or any Affiliate, and the Company shall be immediately entitled to enforce any and all rights and remedies available to the Company pursuant to this Agreement.

(i) *Savings Provision.* If this Covenant Not to Compete is found to be unenforceable by a court of competent jurisdiction, it is the intention of the parties that this Covenant Not to Compete be reformed by such court in such manner that the Redeemed Member is restricted from competing with the business of the Company hereunder from the date of execution of this Agreement to the maximum extent permissible (but not exceeding the time limit and geographic limits set forth herein) under the laws of the {State} {Commonwealth} of _____. If, in any judicial proceeding, a court refuses to enforce this Covenant Not to Compete by reason of length of time, scope or size of geographic area, it is the intention of the parties that this Covenant Not to Compete be reformed by such court so that such period of time, scope or geographic area be reduced to the extent required to cure such invalidity.

(ii) *Tolling.* In the event that the Company alleges a violation by the Redeemed Member and/or any Affiliate in any court of competent jurisdiction of the terms of this Covenant Not to Compete, and it is ultimately determined by such court of competent jurisdiction that the Redeemed Member and/or any Affiliate have violated this Covenant Not to Compete, then any time period set forth in this Section 12(c) shall be deemed tolled at the time such lawsuit contesting the violation of this Covenant Not to Compete is filed and shall remain tolled until such dispute is finally resolved upon the entry of a final judgment or decree.

(d) *Non-Solicitation.* During the payment of the Redemption Price and for a period of one (1) year thereafter, the Redeemed Member and/or an Affiliate shall not:

(i) *Solicitation of Employees.* Directly or indirectly, in any capacity, interfere with, solicit, hire or entice away an employee or former employee of the Company (for the purposes of this Agreement, employee means a person who at the time of such solicitation or hiring has been employed by the Company within the past twelve (12) months); or

(ii) *Solicitation of Customers.* Directly or indirectly, in any capacity, contact, sell to or otherwise solicit business of the type done by the Company from any of the Company's customers or from any of the Company's potential customers (for the purposes of this Agreement, customer means any person, entity or business who at the time of such contact or solicitation had been contacted by the Company within the past twelve (12) months).

(iii) *Savings Provision.* This Section 12(d) and the covenants not to solicit contained herein (this "Covenant Not to Solicit") are reasonable in their limitation and are necessary to protect the legitimate business interests of the Company and that the restraints are not unduly burdensome on Redeemed Member. If this Covenant Not to Solicit is found to be unenforceable by a court of competent jurisdiction by reason of the length of time or scope it is the intention of the parties that this Covenant Not to Solicit be reformed by such court in such manner that the Redeemed Member is restricted from soliciting such employees, customers and potential customers from the date of execution of this Agreement to the maximum extent permissible (but not exceeding the time limit set forth herein under the laws of the {State} {Commonwealth} of _____. If, in any judicial proceeding, a court refuses to enforce this Covenant Not to Compete by reason of length of time or scope, it is the intention of the parties that this Covenant Not to Solicit be reformed by such court so that such period of time or scope be reduced to the extent required to cure such invalidity. This Section 12(d) shall survive the termination of this Agreement for the periods specified herein.

(iv) *Tolling.* If the Company alleges a violation by the Redeemed Member and/or any Affiliate in any court of competent jurisdiction of this Covenant Not to Solicit, and it is ultimately determined by such court of competent jurisdiction that the Redeemed Member and/or any Affiliate have violated this Covenant Not to Solicit, then any time period set forth in this Section 12(d) shall be deemed tolled and the time such lawsuit contesting the violation of this Covenant Not to Solicit is filed and shall remain tolled until such dispute is finally resolved upon the entry of a final judgment or decree.

(e) *Equitable Relief.* No amount of money would adequately compensate the Company for damages which the parties acknowledge would be suffered as a result of the violation by the Redeemed Member of the covenants contained in Sections 12(a), 12(b), 12(c), and 12(d) herein and, therefore, the Company shall be entitled on application to a court of competent jurisdiction to obtain injunctive relief to enforce Sections 12(a), 12(b), 12(c), and 12(d) herein, which injunctive relief shall be in addition to any other rights or remedies available to the Company at law or in equity. If a violation by the Redeemed Member of Sections 12(a), 12(b), 12(c) or 12(d) herein occurs, the Redeemed Member shall be responsible for the payment of all reasonable attorneys' fees, paralegal fees, law clerk fees and other claims, losses, costs, and expenses incurred by the Company on account of violations of Sections 12(a), 12(b), 12(c), or 12(d) herein by Redeemed Member. This Section 12(e) shall survive the termination of this Agreement.

– or –

(a) The Redeemed Member agrees that she will remain bound by Article ___ of the Company Operating Agreement {for a period of _____ after the date of this Agreement} {for the term of the Company}.[77]

(b) The Redeemed Member shall hold in trust for the Company any profits or gains she obtains directly or indirectly from the use of such information and to account to the Company for such profit and gain.[78]

– or –

(a) The Redeemed Member will not communicate, divulge or use for her benefit or that of any other individual, partnership, corporation or to her entity other than the Company or any Affiliate of the Company, any business secrets, manuals of instructions, system manual, reports, business plans, business strategies, budgets, financial and accounting information, systems coding and passwords, personnel information or trade secrets of the Company, or any of the Affiliates of the company, of any type or description, whether written or not ("Confidential Information"); provided, however, that this section shall not apply to any Confidential Information which is in the public domain for a reason other than the negligence, omission or willful misconduct of the Redeemed Member or disclosures which are required under any law, subpoena, summons, court order, or administrative order. Furthermore, the Redeemed Member shall fully comply with the provisions of which she has knowledge under any confidentiality agreements entered into by the Company or any of its Affiliates in the course of their business dealings with any Persons. The Redeemed Member represents that she has delivered all manuals, reports, business plans, product plans, records, data, software and other documents and information in her possession which constitute or contain Confidential Information, including all copies and reproductions of any such Confidential Information whether stored in written form, photographic form, by means of any electronic magnetic, laser or other computer or data processing media, or otherwise.

13. Amendment of the Operating Agreement

(a) This Agreement [does not][does] constitute an amendment to the Operating Agreement.[79]

77. This provision is premised on a comprehensive confidentiality provision in the operating agreement that binds current, but not former, members.

78. This provision should be tailored to state trade secret and competition rules and the nature of the business. If the operating agreement adequately covers competition and trade secrets, it may be more appropriate to simply agree that those provisions will continue to bind the Redeemed Member for some defined period of time.

79. This Agreement may be interpreted as either a free standing agreement or as an amendment to the operating agreement. The latter interpretation may be especially probable if the Remaining Members are parties. *See*, *e.g.*, Ky. Rev. Stat. Ann. § 275.015(14) (LexisNexis 2003), *amended by* 2006 Ky. Laws Ch. 149 (H.B. 234) ("'Operating Agreement' means any agreement, written or oral, among all of the members, as to the conduct of the business and affairs of a limited liability company."); Tex. Bus. Orgs. Code Ann. § 101.001(1) (Vernon 2005) (company agreement means any agreement, written or oral, of the members concerning the affairs or the conduct of the business of a limited

(b) *Waiver of Options and Inconsistencies with Operating Agreement and State Law.*[80] The Company and the Remaining Members hereby waive any rights of first refusal, options to purchase or other rights that they or any of them may have to purchase the Redeemed Member's Interest under the Operating Agreement, statute, or otherwise and expressly agree that notwithstanding any provision of the Operating Agreement or state law, the Company shall not dissolve and wind up but shall continue without interruption after the Effective Time. To the extent any provision of this Agreement is inconsistent with any provision of the Operating Agreement, the parties hereto agree that the Operating Agreement shall be deemed modified to make the transactions contemplated in this Agreement consistent with the Operating Agreement. If any provision of this Agreement or application to any party or circumstances shall be determined by any court of competent jurisdiction to be unenforceable to any extent, the remainder of this Agreement or the application of such provision to such person or circumstances, other than those as to which it is so determined invalid or unenforceable, shall not be affected thereby, and each provision hereof shall be valid and shall be valid and shall be enforced to the fullest extent permitted by law.

14. Other[81]

(a) *Parties in Interest; Successors and Assigns.* No party may assign this Agreement without the prior written consent of the other party. This Agreement shall be binding upon and shall inure to the benefit of the parties hereto, their respective partners, members, and the respective successors and assigns of the parties hereto, and their respective successors and assigns. This Agreement constitutes an agreement among the parties hereto and none of the agreements, covenants, representations, or warranties contained herein is for the benefit of any person or entity not a party to this Agreement.

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liability company). If a redemption agreement is considered part of the Operating Agreement, there will be at minimum confusion and may be unintended consequences such as the application of amendment procedures and the incorporation of arbitration or other dispute settlement mechanisms. *Contrast* Cambio Health Solutions, LLC v. Sloate, 70 Fed. Appx. 816 (6th Cir 2003) and Cambio Health Solutions, LLC v. Reardon, 228 F. Supp.2d 883 (M.D.Tenn. 2002) (arbitration provision in operating agreement held not applicable to contemporaneously executed consulting and severance agreements) *with* Signal Capital Corp. v. Signal One, LLC, No. E2000-00140-COA-R3-CV, 2000 WL 1281322 (Tenn. Ct. App. Sept. 7, 2000) (holding acquisition, employment and operating agreement interrelated and applying to all agreements North Carolina forum selection clause set forth only in acquisition agreement). Decisions made on certain provisions (see, e.g., Sections 2(e), 5(d)) may dictate that this Agreement be an amendment to the operating agreement. In that instance the redemption must receive the approval required for an amendment of the operating agreement, a threshold typically higher than that required for approval of ordinary course transactions.

Note that even though this Agreement may not constitute an amendment to the Operating Agreement, the operating agreement will of necessity be amended as to (a) the list of Members, (b) the listing of capital accounts, (c) any list allocating voting rights among the members, and (d) similar points. *See also* Sections 13, 14(d).

80. Note that this provision, as here presented, is not effective and should not be included unless all of the Remaining Members are parties to the Redemption Agreement.

81. Regarding this section, see Allan G. Donn, *Freedom of Contract and Boilerplate Provisions of Business Entity Agreements*, 8 J. Passthrough Entities 13 (Mar./Apr. 2005).

(b) *Counterparts.* This Agreement may be signed in two (2) or more counterparts, all of which taken together shall constitute one (1) executed original.

(c) *No Broker or Commission Due.* Neither party has dealt with any broker, finder or similar party, and no broker, finder or similar party is entitled to a commission in connection with this Agreement.[82]

(d) *Attorneys' Fees.*[83] If any parties to this Agreement institute any court action or other proceeding of any nature whatsoever (including, but without limitation, any bankruptcy proceeding) to enforce the rights and duties of the parties hereto arising from or in any way relating to the subject matter of this Agreement, the prevailing party or parties in such action or proceeding shall be entitled to recover from the non-prevailing party or parties all costs and expenses incurred by the prevailing party or parties in such action or proceeding, including, but not limited to, reasonable attorneys' fees, paralegal fees, law clerk fees and other legal costs and expenses incurred by the prevailing party or parties, whether incurred at or before the trial level or in any appellate, bankruptcy or other legal proceeding.

(e) *Agreement Drafted by Company Counsel.* The Redeemed Member acknowledges that the Company Counsel prepared this Agreement on behalf of and in the course of its representation of the Company, as directed by {the Manager} {the Remaining Members} and that:

(i) a conflict of interest may and likely does exist between the interests of the Redeemed Member and the interests of the Company, the Remaining Members and/or the Manager;[84]
(ii) the Redeemed Member has been advised by the Company Counsel to seek the advice of independent counsel;
(iii) the Redeemed Member has had the opportunity to seek the advice of independent counsel;
(iv) the Redeemed Member has received no representations from the Company Counsel that this Agreement does not have tax consequences;
(v) the Redeemed Member has been advised by the Company Counsel that this Agreement may have tax consequences;
(vi) the Redeemed Member has been advised by the Company Counsel to seek the advice of independent tax counsel;
(vii) the Redeemed Member has had the opportunity to seek the advice of independent tax counsel; and
(viii) the Redeemed Member acknowledges that the Company Counsel are not and have not been counsel to the Redeemed Member and that the Redeemed Member has placed no confidence in or reliance

82. Consider whether this provision should be moved to the representations/warranties given by each of the Company and the Redeemed Member.

83. Consider whether the costs incurred by the limited liability company in negotiating and entering into the Redemption Agreement will be an obligation of the Redeemed Member, satisfied out of limited liability company assets or otherwise divided. Note that this question is distinct from a cost shifting provision in the event of litigation/arbitration over performance of the agreement.

84. Delete reference to manager if limited liability company is member-managed.

upon Company Counsel to protect her interests in connection with the {transaction provided for herein} {Redemption}.

(f) *Applicable Law.* This Agreement shall be construed and enforced in accordance with the laws of the {State} {Commonwealth} of _____.[85]

(g) *Survival.* All warranties, representations, indemnities, covenants and other agreements of the parties contained in this Agreement shall survive the execution, delivery performance, and termination of this Agreement and shall continue in full force and effect after the Effective Time.

(h) *Arbitration.*[86] Any dispute or question arising as to the interpretation of any clause of, or the rights and liabilities of the parties under, in any manner relating to, this Agreement, if not resolved by negotiation, shall be referred to binding arbitration before a single arbitrator in _____ (_____ County), _____, under the rules and procedures of the {American Arbitration Association} {other arbitration rule setting body} relating to the selection of arbitrators for the determination of issues. This agreement to arbitrate is supported by adequate consideration, receipt of which is acknowledged. The decision of the arbitrator will be binding, final and conclusive on the parties, and judgment on the arbitrator's decision may be entered in any court having jurisdiction thereof. This agreement to arbitrate is binding upon the respective successors, heirs, legal representatives, assigns and transferees of the parties. The arbitrator may, *sua sponte* or upon the written request of a party, issue written directions as to the scope and timetable for discovery. In the event that the arbitrator should determine that the matter(s) in dispute may be resolved by a review of a written record, and that a hearing is not necessary, each party waives the right to a hearing. The arbitrator shall be charged to render a written opinion reciting the facts as determined and the applicable law as applied. The arbitrator may award injunctive and other equitable relief, as well as an award of monetary damages. No claim of fraud, duress or other basis for revocation of contract made with respect to this Agreement shall limit or preclude the enforcement of this agreement to arbitrate except as such fraud, duress or other basis for revocation shall arise with particularity to this agreement to arbitrate, and each party conclusively agrees that this

85. There exists no requirement that the redemption agreement be governed by the law of the jurisdiction of organization of the limited liability company. However, not using the same law could lead to difficulties in interpretation. Certain matters, such as the impact of the redemption upon the solvency of the limited liability company (Section 7) will be governed by the law of the jurisdiction of formation regardless of an otherwise applicable choice of law. Furthermore, a choice of law clause may not govern all claims that arise. For example, a claim of fraudulent inducement to enter into the redemption agreement may apply general conflict of laws principles. *See*, *e.g.*, Gloucester Holding Corp. v. U.S. Tape & Sticky Products, LLC, 832 A.2d 116, 123–25 (Del. Ch. 2003). The applicable Blue Sky law, as it relates to registration requirements and exemptions therefrom and anti-fraud provisions, are based upon the domicile of the offeree/purchaser.

86. There exists no requirement that the redemption agreement contain an arbitration provision. If arbitration is not desired, and the operating agreement provides for arbitration, a specific rejection of arbitration may be in order. *See supra* note 79.

provision shall be interpreted in a manner consistent with the separability doctrine of *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*[87]

(i) *Venue and Jurisdiction.*[88] The parties irrevocably agree that any legal action, suit or proceedings against them, jointly or severally, with respect to the enforcement of any other matter under or arising out of or in connection with this Agreement or for recognition or enforcement of any arbitration or other judgment rendered in any such action, suit or proceeding, shall be brought in the _____ County Circuit Court, or in the _____ District Federal Court, and by execution and delivery of this Agreement, the parties hereby irrevocably accept and submit to the exclusive *in personam* jurisdiction of such court generally and unconditionally with respect to any such action, suit or proceeding for themselves jointly and severally and in respect of their property. The final judgment against any of them in any action, suit or proceeding referred to herein shall be conclusive and may be enforced in any other jurisdiction within the United States of America by suit on the judgment, a certified or exemplified copy of which shall be conclusive evidence of the fact and amount of their obligations and liabilities. The parties hereby irrevocably agree that the service of any and all legal process, summons, notices and documents out of the aforesaid courts or otherwise required hereunder in any such action, suit or proceeding by mailing copies thereof by registered or certified mail, postage prepaid to them at the address set forth in *Exhibit 14(m)* hereof, or to such addresses as they may advise the other parties hereto from time to time. Nothing herein shall in any way be deemed to limit the ability of a party to serve any writs, process or summons in any other manner permitted by applicable law or to obtain jurisdiction over a party, jointly or severally, in such other jurisdictions and in such manner, as may be permitted by applicable law. In addition, the parties hereby irrevocably and unconditionally waive any objection which they may now or hereafter have to laying of venue of any of the aforesaid actions, suits or proceedings arising out of or in connection with the enforcement of any other matter arising out or in connection with this Agreement brought in the aforesaid court, and hereby further irrevocably and unconditionally waive and agree not to plead or claim that any such action, suit or proceeding brought in any such court has been brought in an inconvenient forum or without personal jurisdiction.

(j) *Remedies and Waivers.* All rights and remedies available at law, in equity or under the terms of this Agreement or any other agreement or instrument executed in connection herewith shall be cumulative, and no waiver thereof shall be (a) implied from the prior acts or omissions, or based solely upon the oral rep-

87. 388 U.S. 395 (1967). A number of state arbitration acts are not interpreted to apply the separability doctrine of *Prima Paint. See* Uniform Arbitration Act § 6, cmt. 3 (2002). In those jurisdictions, if the contract at issue does not involve interstate commerce and is therefore governed by the state arbitration act, there may be available defenses and objections to arbitration that would not otherwise be available.

88. Under Delaware law, a member may not be able to waive its right to maintain a legal action or proceeding in the courts of the State of Delaware with respect to matters relating to the organization or internal affairs of a limited liability company. *See* DEL. CODE ANN. tit. 6, § 18-109(d) (2005).

resentations, of a party hereto; or (b) effective or binding unless, and then only to the extent that, such waiver is set forth in this Agreement, or a party hereto signs an express written waiver of rights or remedies and causes such written waiver to be delivered to the party for whose benefit it was made.

(k) *Headings.* The use of titles and headings with references to certain sections of this Agreement are solely for the convenience of the reader and are of no legal effect.[89]

(l) *Gender.* Any reference to a particular gender will be deemed to include all other genders unless the context otherwise requires.

(m) *Notices.*

(1) Each party giving or making any notice, request, demand, or other communication (each a "notice") pursuant to this Agreement shall give the notice in writing and use one of the following methods of delivery, each of which for purposes of this Agreement is a writing:
   (i) personal delivery;
   (ii) registered or certified mail (in each case, return receipt requested and postage prepaid);
   (iii) nationally recognized overnight courier (with all fees prepaid);
   (iv) facsimile; or
   (v) e-mail.[90]

(2) Any party giving a notice shall address the notice to the appropriate person at the receiving party (the "addressee") at the address set forth on *Exhibit 14(m)* or to another addressee or another address as designated by a party in a notice pursuant to this subsection (m).

(3) Except as provided elsewhere in this Agreement, a notice is effective only if (i) the party giving the notice has compiled with the preceding paragraphs (1) and (2) of this subsection (m) and (ii) the addressee has received the notice.[91]

(n) *Further Assurances.* After the date of this Agreement, each party, without further consideration, shall promptly take such actions and shall promptly execute and deliver such documents as may be reasonably requested by another party hereto (or by her or its employees, agents, insurers, or representatives) to effectuate, evidence, authorize, or approve the {transactions contemplated in this Agreement} {Redemption}.

(o) *Interpretation.* The parties agree that this Agreement is the product of negotiation, and expressly waive the rule of interpretation of a writing against the drafter.

(p) *Defined Terms.* Throughout this Agreement various terms have been defined by being initially enclosed in quotation marks and used with their initial letters capitalized. Unless the context otherwise requires, such defined terms will have

89. *But see* DARMSTADTER, *supra* note 1, at 89–93 (positing that headings should have legal effect as indicative of intent of the drafter).

90. Whether notice by fax or e-mail will be permitted is a matter of negotiation.

91. This notice provision is based upon one presented in TINA L. STARK, NEGOTIATING AND DRAFTING CONTRACT BOILERPLATE § 15.15[2] (ALM Publishing 2003).

their designated meaning whenever used in this Agreement or any attached schedules or exhibits. Unless an express reference is made to a different document, all references to a Section or Article shall be understood to refer to the indicated Section or Article of this Agreement, and all references to a Schedule or Exhibit shall be understood to refer to the indicated Schedule or Exhibit attached to this Agreement.

(q) *Severability.* The various provisions of this Agreement as well as the related agreements of the parties are inter-related, and all contribute to and form part of the complete agreement of the parties with respect to the transactions contemplated hereby. In the event that any provision of this Agreement (or of a related agreement) should be determined to be invalid or unenforceable, the balance of the provisions shall be interpreted and applied so as to give maximum legal effect to the agreement of the parties as originally contemplated.

(r) *Authority.* Each of the parties warrants and represents to the other that it has the full power and authority to execute, deliver, enter into and perform this agreement, that the execution, delivery and performance hereof has been fully and properly authorized and approved on its parts, and that the individual executing and delivering this agreement on its behalf has been duly authorized, and is fully empowered, to do so.[92]

(s) *Non-Reliance.* The making, execution, and delivery of this Agreement by the parties hereto have not been induced by any representations, warranties, statements, or agreements other than those expressed in this Agreement.[93]

(t) *Entire Agreement.* This Agreement represents the entire understanding of the parties with respect to its subject matter and supersedes and cancels all prior written or oral contracts, agreements and understandings of the parties with respect to it.[94] No amendment to this Agreement shall be effective unless in a writing executed by all parties.[95]

IN WITNESS WHEREOF, the parties hereto have executed the Agreement as of the date first above written.

Exceptional Widgets, LLC
(the "Company")

By _____

Its _____

Martha Hamilton
(the "Redeemed Member")

_____

92. This provision is partially redundant of Section 5(d).

93. *See* Shelter Mortgage Corp. v. Castle Mortgage Co., L.C., 117 Fed. Appx. 6 (10th Cir. 2004).

94. This provision is based upon that set forth in the Model Asset Purchase Agreement. A merger clause will not necessarily preclude a claim of fraudulent inducement to enter into the redemption agreement or otherwise preclude a claim premised on reliance on pre-formation factual representations. *See*, *e.g.,* Kronenberg v. Katz, 872 A.2d 568 (Del.Ch. 2004); non-reliance clause at Section 14(s).

95. *But see supra* note 13.

TABLE OF EXHIBITS

Exhibit 2(e){(i)} **Redeemed Member's Wiring Instructions**

Exhibit 2(e)(ii) **Promissory Note** *{Exhibit not used if purchase price paid in full at closing}*

{form for promissory note not included in this model agreement}

Exhibit 3 **Description of Indebtedness**

Exhibit 6(c) **Code § 1445(b)(2) Affidavit**

Exhibit 10(a) **Company Tangible Property Fair Market Values**

Exhibit 12(c) **Covenant Not to Compete**

Exhibit 14(m) **Addresses of the Parties**

Exhibit 14(m)
Addresses of the Parties

The Redeemed Member

Martha Hamilton

_____

_____

Fax: _____

E-Mail: _____

The Company

Exceptional Widgets, LLC

Attn.: _____

_____

_____

Fax: _____

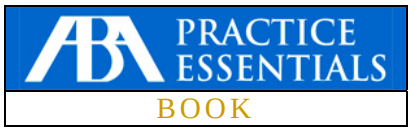
E-Mail: _____

Schedule 2(b)(i)
Delivery Obligations of the Company at Closing

1) A duly executed counterpart of this Agreement
2) The Redemption Price
[3) Releases of guarantees]
[4) Modification of guarantees]
[5) _____]

Schedule 2(b)(ii)
Delivery Obligations of the Redeemed Member at the Closing

1) A duly executed counterpart of this Agreement
[2) _____]
[3) _____]



Model Limited Liability Company Membership Interest Redemption Agreement

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