CHAPTER 1

Overview: Building a Successful Partnership, Joint Venture or Strategic Alliance

By
Craig M. Wasserman
Wachtell, Lipton, Rosen & Katz
New York, New York

Chapter Contents

§ 1.01 Introduction
§ 1.02 Defining the Landscape
§ 1.03 Ten Key Questions to Consider

[1] Is the Client’s Interest in the Venture/Alliance Primarily Strategic or Financial in Nature?
[3] Why Does It Make Sense for the Client to Partner on this Project Rather than Go It Alone?
[4] What Opportunities Will the Client Forego by Entering into the Venture/Alliance?
[6] What Are the Relative Strengths that Each Party Brings to the Table?
[7] What Are the Parties’ Relative Bargaining Powers, Both Up Front and Over Time?
[8] How Much Money Does the Client Wish to Invest in the Venture, Both Up Front and Over Time?
[9] What Are the Expected Exit Strategies, and Do All Parties Have a Shared View of the Likely Exit Scenarios?
Has the Client Adequately Considered All the Things that Could Go Wrong with the Venture/Alliance, So that the Client’s Interests Can Be Adequately Protected in Such Various Downside Scenarios?

§ 1.04 Ten Key Strategies to Follow

[1] Assemble a Core Working Team for the Project
[3] Separate the Proposed Transaction into Its Core Component Parts and Carefully Review the Key Accounting, Tax and Other Financial/Structural Considerations of the Proposed Transaction
[4] Stress Test All of the Key Strategic and Financial Premises
[5] Create a Term Sheet Early in the Process
[6] Create a Separate Issues List of All Key Open Legal, Financial and Structural Considerations that Will Need to Be Resolved
[7] Know What Will Work Best for Your Client Before Engaging the Other Side
[8] Take the Offensive in Putting Forth Proposals to the Other Side
[9] Avoid Ambiguities When It Comes to Drafting the Key Legal Obligations and Responsibilities of the Parties
[10] Consider What Works Best for Both Sides and Be Fair When Drafting Key Terms and Provisions

§ 1.05 A Road map to the Material that Follows

§ 1.06 Joint Ventures with a Distressed Partner

[1] Joint Venture Agreements as Executory Contracts
[2] Application of Section 365 to Joint Venture Agreements
§ 1.01 Introduction

Partnerships, joint ventures and strategic alliances can be among the most complex and difficult forms of business transactions to negotiate and document. The complexity lies in the open-ended nature of a typical partnership or alliance relationship, the complex businesses and business relationships that are often the subject of such enterprises, and the long, and often indeterminate, life of the anticipated venture. Not surprisingly, partnerships, joint ventures and alliances have one of the highest failure rates among all forms of business transactions. There are also a large number of high-profile successes, and new partnerships, joint ventures and alliances are being formed every day. There are few, if any, major corporations that do not engage in some level of partnership, joint venture and alliance activity. Many leading corporations derive a significant share of their revenue or profit, or both, from such activities.

Examples of prominent joint ventures include: Wachovia Securities/Prudential brokerage joint venture, Time Warner’s complex financing joint venture involving its filmed entertainment and cable television assets, AT&T and British Telecom’s short-lived international joint venture designed to provide voice, data and Internet services to multinational firms, and BP’s $6 billion oil joint venture with TNK in Russia. There has also been a rise in interest in joint venture structures by the leading private equity investors, including the joint acquisition by BlackStone, Cypress and PMI of GECC’s financial guarantee business in 2003, and the acquisition of SunGard Data Systems by a consortium of seven prominent private equity firms in 2005.

Despite the prevalence of joint venture and alliance activity and the complex nature of most joint venture projects, there are few pure “joint venture” experts. Unlike other legal and business disciplines, such as mergers and acquisitions, joint ventures and alliances tend to be tackled using an interdisciplinary approach, with general transactional lawyers and business strategy managers taking the lead. Indeed, the two co-editors of this book are themselves general corporate and mergers and acquisitions practitioners, as opposed to sole joint venture specialists, although they have significant experience in the field of joint ventures and alliances. Relatively few lawyers or law firms use the label “joint venture” or “alliance” specialist, though there is an ample supply of lawyers with sizeable joint venture and alliance

---

1 See Fraum, “Discretion, Valor, and Joint Ventures,” Prac. Law., pp. 11-19 (Dec. 2004) (“Joint ventures are a lot like marriages—they can create wonderful offspring or lead to nasty split-ups. And they’re just not for everyone.”).
expertise. There are a number of business consultants and consulting firms that specialize in the field of joint ventures and alliances. Although there are lawyers who specialize in partnership law, this specialty typically relates to the specifics of state partnership law, as opposed to the broader set of joint venture/alliance transactional issues.

Notable, as well, is the fact that most corporations tend to rely on their internal legal and business strategy staff to a much greater extent when negotiating and drafting a joint venture or alliance contract, as compared to other forms of transactions, such as a mergers and acquisitions, where the reliance on outside lawyers and financial advisors tends to be greater. There is some logic here, since most joint ventures and alliances will require a long-term commitment by the corporation to the venture/alliance. It is important to have internal representatives who will be living with this long-term relationship and who fully understand their client’s operational objectives and culture actively involved in structuring and negotiating the key transaction terms. That said, however, the documentation of many joint ventures and alliances is often less robust than might be desired and internal resources can often be effectively augmented with external legal and financial advice. External advisors can add important insights and provide added skills, knowledge and experience to supplement the internal team—and, most important, can provide an independent perspective that may be critical to the venture’s success or to protecting the client in the event the venture fails or reaches an impasse. Too often companies and their internal staffs tend to underemphasize the “what if” scenarios in the drafting stage by focusing too much on the promise of the joint endeavor and not enough on the risks associated with getting locked into a venture that may not always work out as the parties first envision it.

Remarkably, given all the complex issues presented in the joint venture and alliance context, there is little comprehensive analysis of the key concerns that are presented by joint venture and alliance structures within the legal and business literature. This book is intended to address this void, by presenting a comprehensive discussion of legal, business, pragmatic and strategic considerations that are relevant to structuring, negotiating and documenting a successful joint venture or strategic alliance from the perspective of various leading legal and business practitioners in the field.

This overview chapter shares some initial insights regarding how best to begin to tackle the complex world of joint ventures and strate-

---

2 Leading representatives from their fields include the authors of Chapters 9-11 infra.
The chapters that follow address specific topics applicable to the broad range of legal and business issues that arise in the context of most joint ventures and alliances. No one person can be expected to be a master of all relevant knowledge needed to structure and implement such a venture and a team of interdisciplinary experts will usually be needed to analyze appropriately all applicable issues and address and comply with all applicable laws. In the end, the process of negotiating, structuring and drafting joint venture and strategic alliance transactions is itself a joint enterprise among the various legal and business experts that are assembled by the parties to the venture, each of whom brings a piece of the requisite knowledge and experience needed to make the venture a success.

For the transactional lawyers and business team leaders that take the leading role in organizing the overall effort, the ultimate skill needed is an ability to dissect any proposed venture or alliance into its core component parts and to spot all of the key issues that need to be analyzed and addressed. Once any proposed venture or alliance is broken down into its core parts, the venture/alliance will begin to look more familiar. The terms “joint venture” and “alliance” are simply words connoting an element of a shared ongoing business relationship, from which one can draw upon various comparable or analogous precedents. It is important that those handling the transaction understand the core elements of structuring and drafting partnership and limited liability corporation agreements, understand the key elements of an acquisition agreement, understand the basic terms and provisions of a private equity investment agreement, and have a solid foundation in corporate and securities matters. These are the core skill sets needed to help structure and negotiate most joint ventures and strategic alliances. Those structuring the transaction will also need to have tax, antitrust, benefits, intellectual property, finance, accounting and a host of potential other subject matter experts available to help.

Mastering the core conceptual framework applicable in various types of joint venture arrangements is also of tremendous value in the context of negotiating and documenting other types of corporate transactions. Joint venture and partnership concepts can come into play in a variety of contexts. For example, there are numerous acquisitions in which an acquiror purchases a controlling, but only partial, interest in a public company (as in Roche’s initial partial acquisition of Genentech or Toronto Dominion’s partial acquisition of Bank North). Although not a joint venture in the traditional sense, this transaction structure does involve a joint venture or partnership of sorts between the target company’s public shareholders, who continue to hold a significant (though noncontrolling) interest in the target company post acquisition, and the acquiror. Just how far the parties
go in protecting the interests of the public shareholders of the target company in this context can be evaluated by comparing the protections granted to the protections that a single joint venture owner might require if all of the public ownership were consolidated in the hands of a single joint venture partner. So-called mergers of equals between two equally sized public companies can also involve joint venture concepts in the context of the post-merger governance arrangements that are crafted to preserve a balanced contribution from the management and directors of each of the combining entities.

This book has been written with a wide audience in mind and is intended as a resource tool for all participants who have hands-on involvement in negotiating and drafting joint ventures and strategic alliances. Throughout the chapters that follow various authors will set forth a wide range of information and guidance for creating a successful venture or alliance. The purpose is to give the reader a broad, though necessarily general, overview of the subject matter. Specific questions will need to be resolved in the context of a particular transaction and readers should note that generalized rules will not be applicable in all circumstances.
§ 1.02 Defining the Landscape

Throughout this book the various authors use the terms “partnership,” “joint venture” and “strategic alliance” to describe a wide range of business transactions and strategic business relationships. There are numerous alternative definitions of these terms that can be found in various legal, business and vernacular usage. Black’s Law Dictionary, Eighth Edition, for example, defines these terms as follows:

“partnership. A voluntary association of two or more persons who jointly own and carry on a business for profit.* Under the Uniform Partnership Act, a partnership is presumed to exist if the persons agree to share proportionally the business’s profits or losses. *Cf. JOINT VENTURE; STRATEGIC ALLIANCE.”

“joint venture. A business undertaking by two or more persons engaged in a single defined project.* The necessary elements are: (1) an express or implied agreement; (2) a common purpose that the group intends to carry out; (3) shared profits and losses; and (4) each member’s equal voice in controlling the project. - Also termed joint adventure; joint enterprise. *Cf. PARTNERSHIP; STRATEGIC ALLIANCE. [Black’s Law Dictionary also notes by way of citation:]

‘There is some difficulty in determining when the legal relationship of joint venture exists, with authorities disagreeing as to the essential elements . . . . The joint venture is not as much of an entity as is a partnership.” Henry G. Henn & John Alexander, Laws of Corporations Section 49, at 106 (3rd ed. 1983).’”

“strategic alliance. A coalition formed by two or more persons in the same or complementary businesses to gain long-term financial, operational, and marketing advantages without jeopardizing competitive independence through their strategic alliance, the manufacturer and distributor of a codeveloped product shared development costs. Cf. JOINT VENTURE; PARTNERSHIP.”

Notably, the Seventh Edition of Black’s Law Dictionary, updated in 1999, was the first edition of this leading law dictionary to include a definition of the term “strategic alliance” and to recognize the close

---

linkage between all three terms as used in connection with cooperative business ventures. Earlier editions of *Black's Law Dictionary* defined the term “alliance” in the context of unions among families or nations, but did not contain a definition of business or strategic alliances. However, the earlier editions did capture a somewhat broader, and perhaps more accurate, definition of the term “joint venture.” For example, in the Sixth Edition, the term is defined as follows:

“**Joint venture.** A legal entity in the nature of a partnership engaged in the joint undertaking of a particular transaction for mutual profit. Tex-Co Grain Co. v. Happy Wheat Growers, Inc., Tex.Civ.App., 542 S. W.2d 934, 936. An association of persons or companies jointly undertaking some commercial enterprise; generally all contribute assets and share risks. It requires a community of interest in the performance of the subject matter, a right to direct and govern the policy in connection therewith, and duty, which may be altered by agreement, to share both in profit [*sic*] and losses. Russell v. Klein, 33 Ill.App.3d 1005, 339 N.E.2d 510, 512.

“A one-time grouping of two or more persons in a business undertaking. Unlike a partnership, a joint venture does not entail a continuing relationship among the parties. A joint venture is treated like a partnership for Federal income tax purposes. I.R.C. § 7701(a).

**“See also** Community of interest; Joint adventure; Joint enterprise. *Compare* Corporation; Partnership.”^2^

In particular, the Sixth Edition definition does not list as a necessary element that all members have an equal voice in controlling the project (which is not the case in many transactions that are commonly referred to as joint ventures).^3^ As these various definitions demonstrate, there are specific instances in which the terms “partnership” and “joint venture” can be relevant under both state and federal law. Creating a “partnership” relationship among two or more parties, for example, can result in the

---


3 The requirement that each party have an equal voice in controlling the venture is a necessary element under generally accepted accounting principles if the parties to the venture wish to qualify for “joint venture” accounting treatment. Under joint venture accounting method the businesses that each party contributes to the joint venture can continue to be accounted for by the venture at their historical cost as opposed to their fair market value on the date of contribution. However, there are numerous joint ventures, as that term is used in the vernacular sense, that do not qualify for joint venture accounting treatment.
creation of legal rights and obligations among the parties under state law (triggering fiduciary duties, for example) and can result in express obligations of the partners under state and federal tax laws. While the term “partnership” has a more specific legal connotation, the term “joint venture” can also have specific legal applications both in the context of defining the respective duties and obligations of the joint venture participants under state law and for tax purposes. There is also specific accounting treatment permitted for a narrowly defined class of “joint venture” relationships. The term “strategic alliance,” however, as applied to business transactions and relationships, has a less precise meaning and does not generally in and of itself connote the creation of any specific implied rights or obligations among the parties.

The terms “partnership,” “joint venture” and “strategic alliance” are also frequently invoked in a common vernacular context. People will frequently invoke these terms to describe cooperative business ventures without intending to suggest that there is an express or implied legal partnership involved or any other precise legal relationship that is intended to be formed. When entering into a formal business relationship, it is important to recognize that applying partnership and joint venture concepts can result in the creation of unintended implied duties among the parties, if the parties are not careful. In the context of a fully documented business transaction, however, the parties will have ample opportunity (especially in the context of a limited liability company structure) to define specifically the legal relationships that they intend to create and to renounce expressly any intention of establishing implied fiduciary obligations or any other implied obligations or duties. There is no requirement that a joint venture or strategic alliance involve the creation of a new jointly-owned legal entity. Numerous joint venture and alliance structures exist that are based upon long-term contractual arrangements among the alliance or joint venture partners.

Unless the text specifically states otherwise, most uses of the terms “partnership” and “joint venture” throughout this book are intended in the broad vernacular sense of those terms. Moreover, neither the authors who have contributed to this work nor the co-editors mean to suggest that there is any one precise definition that can be applied in all circumstances or any bright line defining the landscape among these various forms of business ventures. Accordingly, the usage of these terms will vary from chapter to chapter as each of the respective authors has deemed it appropriate.

---

See discussion in Chapter 5 infra.

See Chapter 18 infra.

See discussion in Chapter 13 infra.
§ 1.03 Ten Key Questions to Consider

Perhaps more so than in the context of any other form of business transaction, when engaging in the process of structuring, negotiating or drafting a partnership, joint venture or strategic alliance, it is critical to “think” before you leap. What exactly do the parties intend to accomplish by entering into the proposed transaction? What are the potential unintended consequences of their actions? The following questions are designed to focus attention on the fundamental nature of the relationship that the parties have proposed to establish and to stress test the most important assumption, namely, that proceeding with such a venture is sensible and in the client’s best interest. Understanding why a client has decided to proceed with a given transaction, despite its potential risks and costs, will help clarify what types of provisions will be appropriate to include among the key transaction terms and what key commitments from the various parties will be needed to ensure a successful venture.

[1]—Is the Client’s Interest in the Venture/Alliance Primarily Strategic or Financial in Nature?

Understanding the client’s motivation for entering into the venture or alliance is of critical importance. Is the venture intended to bolster the value of the client’s main business or is it a separate project that is being pursued primarily because of its own stand-alone financial prospects? In either case, how important is this venture to the client; does it represent a commitment of a significant amount of resources in relation to the client’s total business or is it incidental to the client’s business and not of key significance? Whether or not the venture itself is of critical strategic importance, are the assets (broadly defined to include tangible and intangible assets, including client relationships) that the client is tying up or intermingling with the venture important to the client on an ongoing basis? If the venture is purchasing assets from others or developing them internally, are they assets that will be of significant strategic importance to the client’s other businesses in the future?

[2]—What Consequences Would Stem from a Sale of the Client’s Interests in the Venture/Alliance?

Is the joint venture or strategic alliance really a disguised sale (namely, has the future destiny of the business being contributed to

---

1 The term “client” is used here in a general sense to represent the company that is entering into a proposed transaction. Both the in-house team and external advisors work for this “client.”
the venture effectively been placed in others’ hands)? If yes, what are the consequences? Is entering into the joint venture or strategic alliance the first step toward a full sale of the business that is being contributed or is the business critical to the client’s ongoing operations and not one that the client would want to divest itself of under any circumstances? The answer to this question will certainly dictate the client’s attitude toward various unwind scenarios. If the client cannot afford to lose control of or influence over the assets contributed to the venture, can the client’s interests be adequately protected through buy-back rights and other protective contractual provisions? Does the client have enough financial and strategic leverage in the relationship to protect all of its vital interests over time?

[3]—Why Does It Make Sense for the Client to Partner on this Project Rather than Go It Alone?

Why not just go it alone? What do the other partners to the venture bring to the table that justifies giving up partial control over a business or strategic assets that may be very important or valuable to the client on an ongoing basis? Does the benefit of the joint venture relationship stem from risk sharing, cost savings, accounting or tax considerations, or is there a set of specialized assets or expertise or network synergies that the client can only tap into by venturing with another party or parties? Does the client have an avenue to buy out the other partners over time and take full control of the venture, are there attractive options available to the client to exit the venture if it cannot take full control, or does the venture retain its value only when it remains an ongoing strategic venture among the original partners?

[4]—What Opportunities Will the Client Forego by Entering into the Venture/Alliance?

What are the opportunity costs of entering into the joint venture or strategic alliance? What commitments does the venture/alliance require that foreclose other business opportunities? Do the strategic and financial rewards promised by the venture justify the commitment of time, assets and funds? Will the client be precluded from entering into relationships with other partners that may provide greater benefits than those presented by the proposed partner? Will the client be precluded from developing business opportunities on its own that

---

could be more attractive/productive than the opportunities that it might develop through the proposed venture?

[5]—What Is the Scope of the Noncompetition and Exclusivity Provisions that Are Envisioned?

It is very common in joint ventures and strategic alliances for there to be broad (and quite often overly broad) noncompetition and exclusivity provisions. Oftentimes, the scope of these provisions reaches far beyond what is needed to protect the integrity of the joint venture itself and presents potential troubling impediments to the client’s future flexibility outside of the venture. Careful consideration needs to be paid to these provisions up front. The broader the scope of noncompetition and exclusivity provisions, the broader the strategic commitment that the partner is forced to make to the venture. Is there balance between the scope of the requested commitments and the strategic benefits and rationale of the venture? Has the client considered all scenarios where these provisions might present undesired restraints and negotiated acceptable exclusions or exits in such circumstances? Are there sufficient exclusions or termination rights to accommodate potential acquisitions by the client that could raise conflicts with the noncompete or exclusivity covenants and to permit a sale or combination with the client? Has adequate consideration been given to how future changes in technology or business practices would be addressed within the boundaries that are intended to be established under the noncompete and exclusivity clauses? When asking these questions, it is important to remember that clients do not remain static over time. Will the answers to these questions vary depending on the future strategic initiatives that the parties pursue away from the joint venture, including in connection with potential future merger or acquisition strategies? Are there exit mechanisms built in, if better strategic opportunities present themselves in the future?

[6]—What Are the Relative Strengths that Each Party Brings to the Table?

Is there a compatible marriage among the parties to the venture? Does each party bring something of value to the table and is the contribution that each party proposes to make to the venture proportionate to the benefits it will receive in return? Joint ventures and strategic alliances typically involve expensive, long-term commitments. Are the proposed parties to the venture the types of entities that warrant such a commitment? Do they have specialized skills, assets, expertise, capital, customers or standing? Are they trustworthy and
respectable and good corporate citizens? What unique attributes do
the partners possess? Do the terms of the venture ensure that the
client will have access to those attributes throughout the life of the
venture? What protections are needed against a change in circum-
stances among the partners (either as a result of a change in control
or a material adverse change in condition)?

[7]—What Are the Parties’ Relative Bargaining Powers, Both
Up Front and Over Time?

Do the parties to the venture have relatively equal bargaining
power or is there one party who has (and is likely to continue to have)
the strong upper hand? All provisions in the venture agreements that
require consensual resolution (such as the need for an agreed-upon
business or marketing plan) should be considered carefully in the con-
text of the parties’ relative strengths and bargaining positions. Will the
client have the effective influence needed to be a true equal partner
in venture decisions or will those decisions likely be dictated by the
desires or requirements of the other partner(s)? In the latter case, has
the client bargained for sufficient minimum protections for its key
financial and strategic interests? Do all parties have equal financial
strength or does one party have significantly deeper pockets than the
other(s)? Will the parties operate on an equal footing regarding
buy/sell provisions and rights of first refusal provisions or will one
party have a significant advantage when exercising such provisions?
Has the client adequately protected itself against the risk of capital
calls that it cannot afford or the risk of a forced dilution of its inter-
est, or both, and against early termination triggers that could operate
to its disadvantage?

[8]—How Much Money Does the Client Wish to Invest in the
Venture, Both Up Front and Over Time?

How much money does the client wish to invest in the venture? Is
there an express limit on the size of the commitment the client is will-
ing to make, either as a result of its limited resources or otherwise?
Is the up-front financial commitment from the partners sufficient to
fund the venture’s needs on a long-term basis or will there be a need
for follow-up financing? If there needs to be follow-up financing, will
that financing come from the original partners or from third-party
sources or both? What provisions are needed to protect the partners
against the risk of default by one or more partners who breach a com-
mitment to provide additional funds? What provisions are needed to
protect partners against undesired dilution in the event of add-on
financings? Are preemptive rights practical in all instances? How
should governance of the venture evolve over time as the ownership interests shift as a result of subsequent financings?

[9]—What are the Expected Exit Strategies, and Do All Parties Have a Shared View of the Likely Exit Scenarios?

Is there an easy exit strategy from the venture in the various alternative scenarios that might develop? Will all parties likely have a similar shared vision of the best exit strategy or will the parties likely have conflicting objectives? If the venture is largely financially motivated, an exit at the best price for all partners may very well satisfy everyone’s objectives. If the venture is of significant strategic importance to more than one party, it is unlikely that all such parties’ strategic objectives can be preserved in an unwind scenario. Who has the most to gain under various alternative exit strategies? Who has the most to lose? What minimum necessary protections does the client need (e.g.: relief from exclusivity and noncompetition covenants, rights to reclaim specified venture assets, such as customer relationships and other proprietary assets)? What minimum financial protections are appropriate (e.g., minimum buyout price)? Oftentimes it has been suggested that a joint venture can serve as a good takeover defense or as deal protection in connection with a planned broader merger or strategic combination between the joint venture partners. Careful attention, however, needs to be paid with respect to just how much value may be transferred from one party to another, or takeover deterrent is created, in the context of the unwinding of the venture. This is especially true if the arrangements are to be scrutinized under enhanced judicial standards in the context of a change of control transaction.

[10]—Has the Client Adequately Considered All That Could Go Wrong with the Venture/Alliance so that the Client’s Interests in Such Various Downside Scenarios?

What has been overlooked? In a typical merger or acquisition agreement, the operative period of time that the contract continues is less than a year. In a joint venture or strategic alliance, the contract will typically continue for years and in many cases in near perpetuity. A lot can change over time. It is hard to draft an agreement that adequately covers all potential alternative states of existence. All that said, it is important to do the best job possible in creating a balanced partnership among the parties. Have all significant risks been identified and are the client’s interests adequately protected in all, or at least most, of those potential scenarios? Are there also adequate
incentives in place (either through the express provisions of the agreement or through the natural incentives built into the venture relationship) to encourage the partners to work to avoid these downside scenarios and to further their mutual best interests? To the extent the success of the venture relies on an element of trust and good faith among the parties, is there a reason to believe that trust will (or will not) continue over time? Are there adequate penalty features built into the agreement to penalize a partner for bad behavior or for failing to deliver upon the minimum expected goals? Are there sufficient exit rights if the venture does not live up to initial expectations? Are there sufficient dispute resolution mechanisms and sufficient notice periods designed to force the parties to use all commercially reasonable efforts to resolve their differences rather than trigger an expensive early termination? Does the senior management at the client adequately understand all of the detailed provisions of the agreements, including the areas where there are full and express protections for the client’s interests compared to those areas where the client’s protections are less than complete?

Careful planning and consideration of the various issues raised by joint ventures is key in all environments and particularly important in a distressed financial environment.⁴

---

⁴ See § 1.06 infra for a discussion of certain issues that can arise in the context of evaluating a joint venture with a financially distressed partner.
§ 1.04 Ten Key Strategies to Follow

After carefully considering what the client hopes to accomplish and what the key risks and rewards of the venture may be, it is necessary to pull together the right group of personnel to put the deal together. Structuring, negotiating and drafting a complex partnership, joint venture or strategic alliance transaction will require an extensive undertaking. It will require significant expertise in various important subject matters and strong team leaders on both the business and legal fronts. While there is no one precise way to go about this task, the following strategies may be of use in beginning to tackle the various tasks involved.

[1]—Assemble a Core Working Team for the Project

As in the case of any complex task, structuring, negotiating and drafting a complex joint venture or strategic alliance requires a team effort, with experts in a variety of subject matters. The project will typically be headed by a business strategy team leader who will report directly to the principal executive officer that has sponsored the project. The project leader will also typically be supported by a senior legal advisor or team of advisors, including internal and outside counsel. The business team will need support in the areas of finance, tax, accounting, strategy and operations and will need to make sure all strategic and business interfaces between the venture and the client’s other operations are carefully considered. The legal team will need to focus on the core deal terms from a corporate transactional perspective and will need expertise in the areas of tax, partnership/llc law, antitrust, intellectual property, securities law, benefits and any venture specific legal specialties.

[2]—Review Analogous Precedent Transactions and Collect Precedent Contracts to the Extent Available

Effective issue spotting is a key to success in gaining mastery over the various important elements of a proposed joint venture or alliance. One of the best means of beginning the process of issue spotting in a proposed transaction is to learn from the past transactions that most closely resemble the current project. Unfortunately, doing so can be difficult in the context of a proposed joint venture or strategic alliance. Relatively few joint venture and strategic alliance agreements are available as public documents, as compared to public company merger agreements and even private company asset purchase or stock purchase agreements. Moreover, there is a wide variety of types of joint ventures and strategic alliances and the contractual provisions vary widely across such forms. In many joint venture or strategic
alliance projects there may be few and potentially no comparable past precedent forms to consider. Even when there are no directly comparable transaction precedents, there will be precedent forms that are useful to consider when reviewing component pieces of the proposed transaction. The art of collecting and molding the best precedents for each key component part of the proposed transaction into a new composite agreement for the venture can be one of the more challenging and rewarding drafting projects that a corporate transactional lawyer can tackle. In all cases, however, past precedents should be used solely as tools to consider in the context of the current deal and each transactional provision should be considered anew in the context of the specific parties to, and the specific objectives which underlie, the new proposed venture.

[3]—Separate the Proposed Transaction Into Its Core Component Parts and Carefully Review the Key Accounting, Tax and Other Financial/Structural Consideration of the Proposed Transaction

Joint ventures and strategic alliances are often best understood by breaking the proposed transaction down into its various component parts. Does the transaction involve a sale of assets or an ongoing operating business to a joint venture entity? If yes, in most instances, all of the normal provisions of a private company sale agreement will be generally applicable to the terms of such a sale. Even though the party contributing the business still may retain up to a 50% interest in the business, it will typically make sense that the joint venture entity treat all terms of the acquisition on an arm’s length basis, regarding representations, warranties, covenants, etc.). Will the ongoing venture require additional agreements among the owners regarding voting, capital contributions and the like. If yes, stock purchase agreements among shareholders in a private equity deal may be a good source for operative language governing the key relationships among the parties. Will there be a new independent management team for the venture that will require its own benefit plans and incentives? If yes, arrangements applicable in a venture capital start-up situation may be applicable here as well. Even where the relationship does not fit neatly into a comparable analogous box, understanding the various component parts will be useful to determine the scope of affirmative and negative duties that will make sense to impose on each party with respect to each component part of their joint venture or strategic alliance relationship. Similarly, it will be necessary to analyze each financial transaction that is expected to occur in the course of the joint venture relationship from a tax and accounting perspective to ensure that all such transactions are being treated appropriately in
accordance with the applicable tax and accounting rules. Especially in the post-Enron environment, extreme care should be taken to make sure that all tax and accounting matters are fully considered. Attempts to recharacterize acquisition premiums as future earnings or to disguise the true economic nature of the financial relationships underlying the joint venture should be strictly avoided.

[4]—Stress Test All of the Key Strategic and Financial Premises

Will the proposed venture bring the strategic and financial benefits that both sides have bargained for and thus justify the investments being made and the opportunities costs associated therewith? Will each party get a fair return on its investment? Are there scenarios that can be envisioned where the terms of the proposed venture result in an unjust advantage for one party over the other? It is important to stress test all of the key strategic and financial assumptions that your client has made when structuring the detailed terms of the venture agreement. Since joint ventures are dynamic transactions that extend over a long life, it is particularly important to make sure that the terms of the venture will adequately protect the client’s core strategic and financial objectives both in the short-term and over the life of the venture. What will happen if the joint venture partner acquires a competing business or enters into a similar joint venture relationship with another similarly situated company? What will happen if there is a fundamental change in the nature of one of the joint venture partner’s businesses? All of the potential alternative scenarios that could occur in the future should be considered and, to the fullest extent practical, addressed in the terms of the joint venture agreements. When issues are compromised (as they must be in any complex negotiation), it is important to make sure the key business principals understand the compromises that are being made and that the client when approving any significant joint venture arrangements understands both the benefits and risks of doing so.

[5]—Create a Term Sheet Early in the Process

The best means of starting to identify all of the relevant issues that will be presented by a proposed venture and to make sure that all parties have the same basic framework in mind for the venture is to put together a detailed term sheet. This topic is addressed in more detail in Chapter 3. A term sheet will focus the working group’s attention on all top-level issues relating to structure, terms and conditions, ongoing governance matters, noncompete and exclusivity issues and exit strategies. While eventually it is a good idea to develop a fairly detailed term sheet for you’re the company’s own internal purposes,
there may be a strategic advantage in keeping the early drafts at a higher general level to achieve consensus from the other joint venture partners before exploring the more detailed provisions where opinions may diverge. There will almost always be some level of initial disagreement regarding the so-called “devil-in-the-detail” among the joint venture partners and therefore a higher-level term sheet that frames the broader outline of the venture may be the best first step in the process. It is often best to work among the joint venture partners to build consensus regarding the key framework for the venture before tackling the harder detailed questions.

[6]—Create a Separate Issues List of All Key Open Legal, Financial and Structural Considerations that Will Need to Be Resolved

The term sheet is a document that the client will likely wish to share among all joint venture participants. Accordingly, there will also be a set of more detailed questions and concerns that should be developed as an internal checklist that is not meant to be shared with participants on the other side (except in the context of exploratory discussions regarding such matters). Keeping track of all of the issues that need to be addressed in the context of a complex joint venture or strategic alliance transaction can be cumbersome and therefore it will be highly beneficial to develop a good checklist of issues to consider and resolve early in the process.

[7]—Know What Will Work Best for the Client Before Engaging the Other Side

Joint ventures and strategic alliances are cooperative ventures that require trust among the parties. For such transactions to work best, each party to the relationship will need to be considerate of the other parties’ interests and work to promote not only his or her own self interests, but the best interests of all parties. All that said, the venture parties are driven by their own strategic and financial goals and trust and cooperation can only be counted on so far. A healthy dose of skepticism is also warranted. Good faith on the part of the partners should not be presumed at the cost of carefully considering leaving the client’s own self interests unprotected. Negotiations regarding the key terms of a venture or alliance are still negotiations and there can be winners and losers in each such negotiation. As such, it is a good idea for each party to develop a game plan on its own first taking into consideration the most significant points that it will need to win in any such negotiations before engaging the other side.
§ 1.04[8] PARTNERSHIPS/JOINT VENTURES/STRATEGIC ALLIANCES 1-20

[8]—Take the Offensive in Putting Forth Proposals to the Other Side

Since it is usually the case that after the senior-most business leaders of the venture or alliance partners shake hands on the deal there are still a lot of details to be resolved among the working groups, it is generally best to take the lead in putting forward proposals on how such details are best resolved. As in tennis, it is usually better to serve than to return (though a good tennis player can also win when playing return by making carefully placed shots against his or her opponent). By taking the pen or lead in drafting proposals on key venture terms, a party will be in a better position to frame the terms of the discussion. Also, by taking the lead, a party’s team leaders can communicate directly with the senior managers on the other side of the deal. Presumably they will read any high-level documents that the other party prepares. By taking the lead, a party may be able to gain buy-in for proposals at a senior level on the other side that would be more difficult to obtain if the same ideas were viewed as counter-proposals or rejections of the other side’s initial requests. Reaching consensus in the context of a complex business transaction is as much art as science, and interpersonal elements and tone can be as important as the underlying substance of the issues at hand. The use of “happy words” will also be important to gain a buy-in. Too often, especially at the term sheet stage, a drafter will seek to hit the other side over the head with an extensive set of protections that he or she wishes to obtain for the client and generate a negative defensive reaction from the other side. The same basic point can often be made in a softer, friendlier tone that will strike a senior business leader on the other side as common sense and not objectionable. For example, it may be better to say in the initial term sheet that “the agreement will provide for customary noncompetition and exclusivity provisions that reflect the significant strategic importance of the relationship that is being formed by the parties” (an apple-pie statement that it is hard to take issue with) than to set forth a detailed list of restrictions that the client insists on imposing on the other side. There will come a time when it will be necessary to serve up that detailed list, but generally it is beneficial to get a senior level buy-in to the conceptual commitment first.

[9]—Avoid Ambiguities When It Comes to Drafting the Key Legal Obligations and Responsibilities of the Parties

Most joint ventures and strategic alliances have a strong aspirational component to them, especially when the venture or alliance involves a start-up business or new business relationship. Despite the fact that the future shape or scope of the business that the
venture/alliance will conduct may be unknown at the time of inception, it is important at the drafting stage to be as specific as possible regarding the key legal obligations and responsibilities of the parties and the limits thereto. The parties can always agree to do more if it makes sense to do so in the future. It is one thing to acknowledge that most parties will likely wish to make additional capital investments if the venture is going well and the rewards of such additional investments are readily apparent. It is another thing to mandate a specific level of additional capital commitments. Most joint venture agreements also contain numerous “agreements to agree,” such as a commitment to agree upon an annual business plan or operating plan for the venture. There is no firm right to enforce an agreement to agree in most legal jurisdictions. Therefore careful consideration should be given to the fall-back rights that exit if the parties fail to reach agreement (for example, the initial business plan will remain in effect or a deadlock provision will kick in requiring resolution or an exit from the venture). It is also important to specify what general duties the parties will have with respect to each other. As indicated above, absent express disclaimers, joint venture partners may be deemed to have implied fiduciary duties.1 If that is not intended, the parties should expressly state so, and should also address related fiduciary topics, such as the parties’ respective obligations with respect to competing corporate opportunities.

[10]—Consider What Works Best for Both Sides and Be Fair When Drafting Key Terms and Provisions

While each side certainly will need to consider its own self interest first, it is also worth remembering that in the context of a long-term business relationship the relationship will need to work for both parties to be successful. So-called “gotcha” tactics should be avoided in most instances—especially when negotiating a long-term joint venture or strategic alliance.2 Serving up fair and balanced provisions will help smooth the negotiation process and avoid wasted time. It will also help to build trust among the parties, which will be critical to the success of the venture, both in its negotiation phase and in its implementation phase. In addition, no joint venture agreement can possibly anticipate all scenarios and potential disputes that can arise over the course of the venture. Taking too heavy handed an approach can come back to haunt the client. It can also justify the other side’s

---

1 See discussion in Chapter 5 infra.
2 See discussion in Chapter 8 infra.
actions in taking an equally heavy handed approach when the client is in the weakened position. All that said, a partner’s kindness should not be relied upon. Counsel should make sure to protect his or her client’s interests in advance.
§ 1.05  A Road Map to the Material that Follows

The chapters that follow provide a comprehensive discussion of the various subject matters that are relevant to structuring, negotiating and drafting most partnership, joint venture and strategic alliance agreements. Chapter 2 discusses the process of getting started, touching on timing, process and disclosure considerations. Chapter 3 discusses letters of intent and terms sheets, which are of tremendous importance in the context of complex joint ventures and alliances. Chapter 4 describes the benefits and limitations of the various choices of venture entities under Delaware law (the most common jurisdictional choice for joint venture entities). Chapter 5 describes the potential fiduciary and other legal obligations of joint venture partners and the options available under Delaware law for limiting such obligations by contract. Chapters 6 and 7 provide a comprehensive review of the key issues that arise in drafting joint venture agreements and their related key ancillary documents. Chapters 8-11 provide additional key insights from leading experts in the field on the best strategies for negotiating and managing successful joint ventures and alliances. Chapter 12 provides a guide to drafting limited partnership and limited liability agreements and Chapter 13 provides a guide to drafting nonentity strategic alliance agreements. Chapters 14 and 14A discuss the special considerations that arise in the context of financial services joint ventures. Chapter 15 discusses the special considerations that arise in the context of real estate joint ventures. and Chapter 16 discusses the key considerations that arise in the context of minority strategic investments. Then Chapters 17-21 address the specific issues that arise in the special subject matter areas of antitrust, tax, federal and state securities laws, and intellectual property, and employment retention and benefit matters. The Appendices at the end contain a useful compilation of various precedents, checklists and forms.

While the editors have attempted to organize this book in a logical sequential order, the chapters need not be read in precise chapter order. Each chapter has been written to stand on its own. In the end, the objective of this book is to make each reader a more critical thinker when it comes to tackling the tasks at hand in the context of any partnership, joint venture or strategic alliance transaction. All transactions will differ, but all share common elements as well. While no one roadmap will be right for all transactions, the lessons and experience reflected in the various chapters that follow are intended to set the reader on the best course possible to achieve a successful outcome.
§ 1.06 Joint Ventures with a Distressed Partner*

The risks and uncertainty that arise when a business partner becomes distressed may be particularly acute in the context of a joint venture relationship. Joint venture partners often have a substantial shared interest in, and some degree of co-dependency with respect to, a common venture. Indeed, the venture agreement may provide for shared management and governance rights, capital commitments, rights to distributions, restrictive covenants, indemnities, buy-out or preemptive rights, restrictions on transfers of interests in the joint venture and other indicia of a relatively close-knit, carefully structured relationship.

As a result, if a partner files for bankruptcy protection, the non-debtor partners will need to consider a variety of business and legal issues—such as the risk that capital contributions or other payments made by the debtor-partner to the joint venture may be recoverable by the bankruptcy estate on fraudulent conveyance or preferential avoidance grounds, and the enforceability of indemnification or other payment obligations of the debtor-partner. In this regard, non-debtor partners may wish to consider some of the protective measures discussed above in connection with other strategic business relationships, including obtaining a lien or security interest in the debtor’s partnership interest or other property in order to secure a damages claim, or maintaining a setoff right against distributions to the debtor. Joint venture partners should also be mindful of the automatic stay and refrain from taking actions that could be deemed impermissible actions to obtain possession of or exercise control over property of the debtor’s estate, including the debtor’s interest in the joint venture.

One area where partners’ concerns may be especially heightened is the application of Section 365 of the Bankruptcy Code, which invalidates ipso facto clauses and permits debtors to reject, assume or assign executory contracts, and its impact on the partners’ contractual relationship. Non-debtor partners will be keen to assess their ability under this section to expel the debtor-partner from the partnership, terminate the venture and/or exercise any buy-out rights provided under the joint venture agreement. Section 365 also impacts whether the debtor-partner will be entitled to assume and assign its rights and obligations—including governance rights—to a third party without the consent of the non-debtor partners. The resolution of these issues turns not only on bankruptcy rules but also on the terms of the joint venture agreement.

---

venture’s operating agreement, the facts and circumstances of the partners’ relationship, applicable state laws and, due to fairly substantial divergences in case law, the particular bankruptcy court that is tasked with addressing these questions.¹

[1]—Joint Venture Agreements as Executory Contracts

A threshold question in assessing the impact of a bankruptcy filing on a joint venture is whether the partnership agreement, limited liability company agreement, shareholders agreement or similar operating document is an executory contract. As noted above, Section 365 of the Bankruptcy Code provides that a Chapter 11 debtor will be entitled to reject or assume its executory contracts, and it neutralizes the effect of ipso facto clauses and anti-assignment restrictions in such contracts. However, Section 365 also contains some important limitations based on applicable non-bankruptcy laws that can serve to protect the interests of the non-debtor partners.

There is substantial case law to support the conclusion that partnership and similar agreements are executory contracts, especially where the venture is premised on some degree of joint management and control as compared to partnerships that have active general partners and passive limited partners.² For example, in In re Allentown Ambassadors, Inc., the court held that an LLC operating agreement was an executory contract because the members “had ongoing, material, unperformed obligations to one another and the LLC,” including the duty to manage the LLC and the duty to make additional cash contributions if needed by the LLC.³

¹ See 11 U.S.C. § 362(a)(3); see, e.g., In re Daugherty Construction, Inc., 188 B.R 607, 615 (Bankr. D. Neb. 1995) (holding that actions taken by LLC members—including holding meetings, voting to continue the business of the LLC, removing a debtor as manager of the LLC, approving a new manager and adding new members—violated the automatic stay, but declining to impose sanctions since the actions appeared to be good faith attempts to protect the members’ LLC interests).

² There are only a few provisions in the Bankruptcy Code that specifically address partnership issues, and efforts to revise the Bankruptcy Code to provide more guidance in this area have generally not been fruitful. See, e.g., “Bankruptcy: The Next Twenty Years—National Bankruptcy Review Commission Final Report,” pp. 371-449 (Oct. 20, 1997) (noting that “[c]onflict often exists between the result of a partner’s bankruptcy filing under state partnership law, the result under the Bankruptcy Code and the result under the partnership agreement itself” and making recommendations to Congress for reforms).

³ See, e.g., Milford Power Co., LLC v. PDC Milford Power, LLC, 866 A.2d 738, 750 (Del. Ch. 2004) (“the substantial weight of federal authority which treats agreements for the operation of entities like limited partnerships and LLCs as executory contracts when those agreements contemplate an important, on-going role for the debtor in management”).

(Rel. 13)
However, there is no per se rule and courts have sometimes reached the contrary conclusion. For example, in *In re Garrison-Ashburn, L.C.*, the court concluded that an LLC agreement was not an executory contract because it merely provided structure for the management of a company and imposed no duties or responsibilities on the members.\textsuperscript{4} In short, courts typically apply the Countryman definition,\textsuperscript{5} looking to the substance of the agreement to determine whether there are material unperformed obligations by the parties.

### [2]—Application of Section 365 to Joint Venture Agreements

If a joint venture agreement is an executory contract, the debtor-partner or the trustee of its estate may seek to invalidate ipso facto provisions and/or restrictions on assignability that operate to its detriment. Examples include clauses providing that a partner must withdraw from the partnership in the event such partner files for bankruptcy protection, and clauses granting the other partners certain rights to purchase a bankrupt partner’s interest in the venture at a specified price. Section 365(e)(1) of the Bankruptcy Code provides that, notwithstanding any provision in the contract or in applicable law, no right or obligation under the contract may be terminated or modified based solely on an *ipso facto* provision in the contract.

\textsuperscript{4} In re Allentown Ambassadors, Inc., 361 B.R. 422, 444 (Bankr. E.D. Pa. 2007). See also:

*Second Circuit*: Hoffman v. Vecchitto (In re Vecchitto), 2000 U.S. App. LEXIS 25439 at *4 (2d Cir. Oct. 11, 2000) (citing Riodizio, infra, and holding a shareholder agreement was an executory contract); In re Riodizio, Inc., 204 B.R. 417, 425-426 (Bankr. S.D.N.Y. 1997) (holding a shareholders agreement that contained a non-compete obligation, right of first refusal, board designation rights and supermajority shareholder vote requirements was manifestly an executory contract).

*Fourth Circuit*: Broyhill v. DeLuca (In re DeLuca), 194 B.R. 65, 77 (Bankr. E.D. Va. 1996) (holding LLC agreement was an executory contract because the object of the agreement—the development of a real estate project—had not yet been accomplished and the parties had ongoing duties and responsibilities to bring the project to a successful conclusion).


\textsuperscript{5} In re Garrison-Ashburn, L.C., 253 B.R. 700, 708-709 (Bankr. E.D. Va. 2000). See also:

*Fourth Circuit*: In re Tsiaoushis, 2007 U.S. Dist. LEXIS 53376 at **4-13 (E.D. Va. July 19, 2007) (holding an LLC agreement was not an executory contract because the debtor was not a manager or director, did not owe a fiduciary duty and had no unperformed duties).

*Ninth Circuit*: In re Ehmann, 319 B.R. 200, 204-206 (Bankr. D. Ariz. 2005) (holding LLC agreement for an entity used to reduce estate tax liabilities provided only for rights and not obligations of members and thus was not an executory contract, and noting “it is facile to assume that all partnership agreements are executory contracts”).
Accordingly, debtor-partners have contended—with mixed success—that mandatory withdrawal, dissociation and buy-out provisions are rendered ineffective by Section 365(e)(1). In addition, Section 365(f)(1) provides that a trustee may assign an executory contract notwithstanding any contractual provision or applicable law that prohibits, restricts or conditions the assignment.

Cutting against these claims are Sections 365(e)(2) and 365(c)(1), which provide that ipso facto clauses will not be nullified and a trustee may not assume or assign an executory contract if “applicable law excuses a party, other than the debtor, to [the executory contract] from accepting performance from or rendering performance to” an entity other than the debtor, and the party does not consent to the assumption or assignment of the contract. Thus, to the extent that a joint venture agreement cannot be assigned and non-debtor partners cannot be forced to accept a substitute member under applicable non-bankruptcy laws, Section 365 may operate to preserve the rights and expectations of the non-debtor partners.

The application of Section 365 in the joint venture context is complicated by references therein to applicable state laws, which vary in certain respects and provide differing default rules depending on the type of joint venture entity (limited partnership, limited liability company, etc.). Moreover, the application of state laws sometimes leads to a result that conflicts with the language and principles of Section 365. For example, some state laws—such as Section 18-304 of the Delaware Limited Liability Company Act—provide that a person will cease to be a member if such person files a voluntary petition for bankruptcy or is adjudged insolvent, unless the LLC agreement provides otherwise or all of the other members provide written consent to the contrary. Some courts have held that such provisions are essentially ipso facto restrictions that are preempted by Section 365(e)(1).\footnote{This so-called “Countryman” definition of “executory contract” was set forth in Countryman, “Executory Contracts in Bankruptcy: Part 1,” 57 Minn. L. Rev. 439, 460 (1973). The original rationale is that if the debtor has no remaining material obligations (i.e., only the non-debtor has obligations), then there is no point in rejecting the contract—the debtor is the beneficiary of performance and will choose to enforce the right to performance. If the non-debtor has no remaining material obligations (i.e., only the debtor has not yet performed its obligations), then there is no point in assuming the contract—the contract is essentially a liability and the debtor will choose to reject it. It should be noted that a minority of courts adopt a “functional test” in determining whether a contract is an executory contract, pursuant to which the primary consideration is the impact of the assumption or rejection decision on the estate. A classic executory contract would be a long-term supply contract under which the debtor is required to take delivery and pay for goods in the future.}
In addition, under Section 18-702(b)(2) of the Delaware Limited Liability Company Act, interests in an LLC are assignable but assignees will have no right to participate in the management of the LLC, unless otherwise provided in the LLC agreement. In contrast, Section 541(c)(1) of the Bankruptcy Code provides that a debtor’s property interests become property of the bankruptcy estate notwithstanding any ipso facto provisions in an agreement or applicable non-bankruptcy law.

Courts have adopted differing approaches in attempting to reconcile these various provisions of Section 365 with state law and the terms of the joint venture agreements. In Midland Power Company, the Delaware Court of Chancery considered whether an ipso facto clause in an LLC agreement, which required the automatic withdrawal of a debtor as a member of the LLC upon the debtor’s filing of a bankruptcy petition, was effective to divest the debtor of its membership rights. The court noted that Section 18-304 of the Delaware Limited Liability Company Act “expressly recognizes the unique relationships that exist among members of LLCs and protects solvent members from being forced into relationships they did not choose that result from the bankruptcy of one of their chosen co-investors.” However, the court also noted that Delaware law generally provides for the assignability of LLC interests (but not management rights). In attempting to harmonize these principles, the court concluded that the ipso facto clause and Section 18-304 operated to deprive the debtor of its ability to participate as a member in the LLC’s governance, but did not bar assignment of the debtor’s “bare economic rights” as an equity owner.

---

7 See, e.g.: Second Circuit: In re Matta, 1995 Bankr. LEXIS 1606 at **7-10 (Bankr. D. Vt. Nov. 6, 1995) (holding Section 541(c)(1) of the Bankruptcy Code preempts a state’s ability to divest a debtor of its right to conduct business in a partnership simply because the debtor sought bankruptcy relief, and, therefore, a state law providing for dissolution of the partnership when any partner became bankrupt was ineffective).

Third Circuit: In re Rittenhouse Carpet, Inc., 56 B.R. 131, 131-132 (Bankr. E.D. Pa. 1985) (“On the basis of § 365(e) and the Supremacy Clause of the U.S. Constitution, we conclude that removal of a debtor/partner may not be predicated merely on the filing of a petition in bankruptcy, notwithstanding provisions of state law to the contrary.”).

8 Milford Power Co., LLC v. PDC Milford Power, LLC, 866 A.2d 738, 754 (Del. Ch. 2004). See also, 6 Del. Code Ann. § 15-601(6)(b) (2009) (providing that a partner is dissociated upon a voluntary filing for bankruptcy or upon being adjudged insolvent or bankrupt). For examples of other cases which have emphasized the “personal services” nature of partnership and LLC agreements, see, e.g.: In re DeLuca, 194 B.R. 65, 77 (Bankr. E.D. Va. 1996) (holding that due to the nature of the members’ duties and responsibilities to complete a real estate project, the LLC agreement
In other cases, courts have proposed a “facts and circumstances” approach that focuses on the actual consequences to the non-debtor partners of allowing management rights to be assumed or assigned, and whether substitute performance would deprive the non-debtors of the benefit of their bargain. For example, in *In re Antonelli*, the court reasoned that the identity of the member was not critical to the partnership and the non-debtor partners would “not be adversely affected by an assumption or assignment transaction, whereas the debtor and its estate may realize substantial benefits” from such a transaction.

As a result, the court concluded that a plan of reorganization that effectively assigned the debtor’s management rights in certain partnerships was not precluded by Section 365(c)(1).

In short, the case law in this area is complex and conflicting, and the rights of non-debtor partners vary considerably based on the specific facts and circumstances of the joint venture.

---

9 Milford Power Co. LLC v. PDC Milford Power, LLC, 866 A.2d 738, 760-762 (Del. Ch. 2004), citing and following Northrop Grumman Technical Services, Inc. v. Shaw Group Inc. (In re The IT Group, Inc.), 302 B.R. 483, 487 (D. Del. 2003) (holding debtors were permitted to assign their bare economic interests, subject to right of first refusal (which was not an ipso facto clause because it was triggered by any transfer of interests), but buyout right which would have capped the purchase price was an invalid ipso facto clause).

10 See Summit Investment and Development Corp. v. Leroux, 69 F.3d 608 (1st Cir. 1995) (holding ipso facto termination clause in limited partnership agreement and limited partnership statute were unenforceable against debtor partner general).

11 In re Antonelli, 148 B.R. 443, 449 (D. Md. 1992); see also id. at 448 (“the question of whether or not management power in a partnership is assignable turns not upon the status which ‘applicable law’ generally accords to partnership agreements but upon the materiality of the identity of the partners to the performance of the obligations remaining to be performed under the partnership in question”).