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REAL ESTATE VENTURE EXIT STRATEGY PROVISIONS

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Exit strategies are a key consideration in any real estate venture relationship. In this article, **Stevens A. Carey** discusses three alternative exit strategy provisions (with forms) in the context of a real estate venture agreement between an institutional investor and an operator/developer: (1) a right to cause a unilateral property sale subject to a right of first offer; (2) a buy/sell; and (3) a put/call.

Note: What appears in the printed edition of this article is an abbreviated version of the article that omits endnotes (which contain citations and other information) and appendices (which contain sample provisions and a discussion of tax-free exchanges). This online edition contains the complete article, with endnotes and appendices.

Real Estate Venture Exit Strategy Provisions

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SOMETIMES THE PARTIES to a real estate venture assume they will act in harmony and the venture agreement they spent so much time negotiating will be filed somewhere and all but forgotten. However, parties and circumstances change. And often potential conflicts are or should be evident from the outset (e.g., different tax positions, liquidity needs or long-term goals). Whether foreseeable or not, what if conflicts arise and make it difficult for a party to liquidate or to remain in the venture? How does a party end its investment or at least end the venture relationship with the other party? In the author's experience, a common response to these concerns, when they are considered at the time the venture is formed, is to include one or more of the following rights in the venture agreement:

- A unilateral (property) sale right;
- A right of first offer (tied to a unilateral property sale right);
- A buy/sell right;
- A put right; and
- A call right.

This article will begin by establishing the context, terminology and assumptions that will frame the discussion. It will then explain the meaning of "exit strategy" in this article (and in particular, how buy/sells, rights of first offer, and calls may be thought of as exit strategies). It will then briefly discuss statutory exit rights and membership interest sales to third parties and why they are not further addressed in this article. The remainder of this article will discuss the sample provisions (the "**Sample Provisions**") that appear in Appendix A to this article and concepts and concerns they are intended to address, first generally and then in the order in which they appear:

- Unilateral Sale (§ 12.1);
- Right of First Offer (§ 12.2);
- Buy/Sell (§ 12.3); and
- Put/Call (§ 12.4).

1. TERMINOLOGY AND ASSUMPTIONS

Limited liability company ("**LLC**") terminology is used although most, if not all, of the discussion applies equally to partnerships.[1] Also, the following statements are assumed as facts (unless otherwise stated):

(1) An institutional investor and a local operator/developer form a single-purpose LLC to acquire and operate a real estate project (the "**Property**"); and

(2) The agreement governing the LLC (the "**LLC agreement**") includes:

- A unilateral sale right ("**Unilateral Sale Right**"), which provides that either member[2] may cause the venture to sell the Property, subject to a right of first offer ("**ROFO**"). Two alternative ROFOs are addressed (each of which begins with a notice from the member initiating the Unilateral Sale Right): in one, the initial notice is *an offer to* the non-initiating member, and in the other, the initial notice is a *request for an offer from* the non-initiating member. In either case, the *offer* contains a price for the Property.[3] If the offer is accepted, then there is an inter-member sale of the initiating member's interest to the non-initiating member for a price that is based on what the initiating member would receive from a hypothetical sale of the Property at the stated price; and if the offer is not accepted (or in the case of an offer to be made by the non-initiating member, if the offer is not made), then the initiating member may, for a certain period of time, cause the sale of the Property to a third party, but if an offer has been made, then the third-party price may not be less than the price stated in the offer (subject to a margin of error);

- A buy/sell right ("**Buy/Sell**"), which provides that either member may name a price for the Property[4] and the other member must then decide whether to sell its membership interest to the initiating member or buy the initiating member's membership interest, where the price for each member's membership interest is based on what it would receive from a hypothetical sale of the Property at the stated price; and

- A put/call right ("**Put/Call**"), which provides that one specific member (the purchasing member) may call ("**Call**"), and the other member (the selling member) may put ("**Put**"), the selling member's interest, for a price equal to what the selling member would receive from a hypothetical sale of the Property[5] at a price established by an agreed-upon valuation procedure (e.g., an appraisal process).[6]

A prior article (the "**Hypothetical JV Sale Article**")[7] discussed the hypothetical Property sale by the JV used in the ROFO, the Buy/Sell or the Put/Call, in order to price the interests of one or both the members for purposes of the inter-member sale that may be the end result. The Hypothetical JV Sale Article included sample provisions used for this special type of inter-member sale. Appendix A to this article includes (with some modifications) those same provisions and, in addition, sample provisions for the Unilateral Sale subject to the ROFO, the Buy/Sell and the Put/Call that may (or in the case of a Unilateral Sale, may not) lead to such inter-member sale.

2. EXIT STRATEGIES: EXIT FROM WHAT?

What is an "exit strategy"? Many people think of it as "their plan for how and when they will sell the investment and take their profit."[8] In the context of a real estate venture investment, there is another layer to consider for the members: the "exit strategy" for a member might be either (1) an exit from its investment, or (2) more generally, an exit from its venture relationship with the other member in the venture.[9] The first alternative

accomplishes both exits. But the latter alternative may result in an increase in, rather than a liquidation of, the investment.

2.1 Disposition Strategies. A unilateral sale right (whether or not subject to a ROFO) and a put are strategies to *exit from the investment*.

2.2 Acquisition Strategies. By contrast, a call, a ROFO and a buy/sell are generally not good strategies to *exit from the investment* because a call will, and a ROFO and a buy/sell might, yield the opposite result: an *acquisition* rather than a *disposition*. Indeed, a call, a ROFO and the "buy" election under a buy/sell, may be viewed as *retention* or *acquisition* strategies in relation to the investment (and may be an inefficient step if the ultimate goal is to sell the Property promptly after the acquisition).

It is clearly easier if the members are aligned in their strategies to exit *from their investment* in the Property. When they are not, a disposition strategy can be very difficult to implement. Unfortunately, such alignment is often not present. When it is not, each member may want some ability to part ways. This article is focused on the more general exit (from the JV relationship), which may also be utilized as a dispute resolution mechanism.[10] Indeed, the Unilateral Sale, ROFO, Put/Call and Buy/Sell are all strategies to *exit from the JV relationship with the other member*.

3. STATUTORY EXIT RIGHTS

A member may have statutory rights to exit from the venture by, for example, putting its interest to the venture or causing a judicial dissolution. In the author's experience, the members usually try to avoid such rights by using Delaware law to govern their LLC agreement and then supplanting any such rights by some variation of one or more of the exit strategies discussed in this article. However, on occasion, one may encounter a venture agreement that is silent regarding exit strategies or fails to eliminate such statutory rights. In such cases, the applicable statutory rules may be relevant.

3.1 Statutory Put Right. Although LLC statutes vary by state, some provide, as a default rule, that a member may withdraw and receive compensation (e.g., the fair value) for its interest.[11] This default rule existed even in Delaware at one time and continues to exist for some older Delaware LLCs: a member in a Delaware limited liability company formed on or before July 31, 1996, not otherwise restricted by the LLC agreement, may resign and demand the fair value of its interest.[12] In 1996, the Delaware Limited Liability Company Act was amended (for Delaware LLCs formed after July 31, 1996) so that a member may not resign unless the LLC agreement provides otherwise.[13] More importantly, the Delaware LLC Act provides that the right of a resigning member to receive the fair value of its interest is subject to what is otherwise provided in the LLC agreement.[14] And it is common, in the author's experience, for real estate venture agreements to provide that, except as otherwise expressly provided in the LLC agreement, a withdrawing member is not entitled to receive any distributions and is not otherwise entitled to receive the fair value of its interest.

3.2 Judicial Dissolution. Another common statutory exit right is judicial dissolution.[15] For example, the Delaware LLC Act provides:

> On application by or for a member or manager the Court of Chancery may decree dissolution of a limited liability company whenever it is not reasonably practicable to carry on the business in conformity with a limited liability company agreement.[16]

This basis for judicial dissolution appears in many LLC and limited partnership statutes.[17] But what does it take to satisfy the "not reasonably practicable" standard? According to one resource:

> [N]either disgruntlement nor discomfort suffice. The fact that a member is deeply dissatisfied does not justify dissolution, nor does the fact that "[the venture] has . . . proven deeply disappointing." Likewise, the fact that the members have a contentious relationship is insufficient.[18]

However, an impasse may be enough.[19] As stated by the Delaware Court of Chancery:

> [D]issolution is reserved for situations in which the LLC's management has become so dysfunctional or its business purpose so thwarted that it is no longer practicable to operate the business, such as in the case of a voting deadlock or where the defined purpose of the entity has become impossible to fulfill.[20]

On the other hand, judicial dissolution is a discretionary remedy[21] and, more importantly, the statutory right to judicial dissolution has been held to be waivable under Delaware law.[22] But note that the Delaware Chancery Court can exercise its equitable powers to judicially dissolve an LLC (separate and apart from the Delaware judicial dissolution statute) and a party's standing to seek equitable dissolution may not be waivable.[23]

3.3 Other Statutory Exit Rights. Other statutory exit rights (e.g., expulsion)[24] are beyond the scope of this article.

4. THIRD-PARTY MEMBERSHIP INTEREST SALE

Noticeably absent from the exit strategies in the Sample Provisions is a sale of a member's interest to a third party (and the associated bells and whistles, such as rights of first offer, tag-along rights and drag-along rights, at the membership interest level). It has not been addressed because, with the exception of certain 100% ownership interest transfers,[25] it is often, if not usually, an inferior exit strategy that leads to a less profitable outcome (when compared to a sale of the Property).[26] Why? The members do not have the same alignment that they have in a Property sale: one is leaving and one is staying. For this reason, there may be restrictions in the LLC agreement to protect the continuing member (e.g., approvals or qualified replacement tests, aside from rights of first offer and rights to tag along with the sale) that encumber the process. And even if the LLC agreement is drafted in a manner to minimize such requirements, it may be much more difficult to get buyers interested in and comfortable with the purchase of a membership interest. A buyer must be sold not only on the Property but also on the venture vehicle, the choice of co-venturer and other matters (e.g., the business plan) that may not be easy or possible to change. What are the chances that a buyer and the continuing member will have the same views, hopes and plans for the Property and how will the compromises a buyer is forced to make affect the pricing for the sale? A more detailed list of the problems (assuming less than 100% of the membership interests is being transferred) follows:

4.1 Pricing. The selling member may be leaving money on the table by selling a partial interest:

> Interests in a joint venture are generally less marketable than the entirety of the partnership interests or the partnership property itself, and a sale of a portion of the interests is likely to generate fewer proceeds to the exiting partner than its share of the proceeds of an asset sale.[27]

Even if buyers do not explicitly discount the price on account of the partial interest, there may be less market interest for the reasons explained below; and the reduction in competition may yield a lower price.

4.2 Existing Venture Agreement. When a venture is formed, each of the members may see value in teaming up with the other member. But at the time of a membership interest sale, they may no longer see that value. They might not even be getting along. And while a member may welcome the opportunity to sell its interest to exit its relationship with a difficult partner, some buyers may not be interested in taking their place for the very same

reasons. Even if the selling member still values the relationship, a buyer may view things differently. Some buyers already have the capital, expertise and manpower to run a project by themselves and have no interest in investing through ventures. This may rule out some buyers from the outset. And those buyers who are willing to consider a joint investment may have concerns with the existing venture agreement (including the parties to that agreement).

4.2.1 *Control*. The selling member may not have the level of control desired by the buyer (and certainly not the same level of control the buyer would have if it acquired 100% of the Property). Even if the buyer is acquiring a controlling interest, having another owner involved is likely to make some, if not many, decisions more time-consuming and more complicated.

4.2.2 *Other Venture Terms; Continuing Member Compatibility and Cooperation*. More generally, the buyer may not be comfortable being in a venture with the continuing member on the terms in the existing LLC agreement (recognizing that buyers, especially large investors, often have their own unique requirements that they want addressed in each of their venture agreements). In addition to possible issues relating to control, as noted above, potential buyer concerns may include:

- the continuing member's reputation and satisfaction of any applicable KYC (know your customer) requirements;
- tax (e.g., REIT, UBTI or foreign investor issues),[28] ERISA or similar legal concerns that may not be shared by the continuing member; and
- the continuing member's development, operating or disposition strategy, which may differ from the buyer's (e.g., the buyer may want to reposition the asset while the continuing member may be satisfied with the status quo, or the continuing member may want a much longer holding period because the Property has significant built-in gain).

Even if the buyer and the continuing member have compatible views regarding the Property, will the continuing member provide the cooperation necessary to close the sale with modifications to the LLC agreement or an estoppel certificate or both that will satisfy the buyer (or will it be willing to do so only at a cost to the selling member that reduces the effective price to the selling member)? And will the selling member be able to satisfy all the requirements (in favor of the continuing member) in the LLC agreement to permit the sale?

4.3 Existing Venture Liabilities. A disadvantage of any ownership interest acquisition (even an acquisition of 100% of the ownership interests) is that the buyer's investment will be subject to all of the venture's existing liabilities, known or unknown. Inheriting problems (especially unknown problems it may not be able to diligence) can be a scary proposition for a buyer. It may lead to difficult negotiations over representations, indemnifications, survival limits and liability caps, which in turn may increase the time and cost of the transaction and hamper the selling member's ability to liquidate and minimize the scope and duration of its post-sale liability.

4.4 Title Issues.

4.4.1 *Existing Title Insurance*. The buyer may be concerned that the venture's existing title insurance coverage is inadequate because:

- it is out of date;
- the coverage may be less than the current value of the Property; or

- it may not be available due to the knowledge, acts or omissions of the existing members.

If so, the buyer may want better title insurance. But unless the selling or continuing member is willing to pay the additional costs, the buyer may not want coverage for more than its interest. Will it be possible to obtain acceptable coverage for the buyer alone and if it is possible, will it be complicated and time-consuming to do so?[29] Whether the buyer is obtaining new coverage or relying on existing coverage, it may still not want that coverage to be impaired by the knowledge, acts or omissions of the existing members.[30] The selling member may be willing to provide the title company a non-imputation indemnity as to its own knowledge, acts or omissions. But who will be willing to provide a non-imputation indemnity as to the continuing member?

4.4.2 *Title to Membership Interest*. Of course, the venture's title to the Property may not matter if the buyer does not acquire good title to its membership interest. What assurance will satisfy the buyer that is acquiring such title? Much like the undisclosed liabilities discussed in Section 4.3 above, the buyer will want representations from the selling member assuring that it is acquiring such title, which may exacerbate survival and credit enhancement issues.[31] Representation and warranty insurance might be a solution to this problem.[32] But such insurance involves an additional document (the insurance policy) to negotiate and an additional cost (the premium). And even if such insurance is obtained, it will not supplant the need for customary due diligence (e.g., UCC, litigation and lien searches).

4.5 Existing Financing. And what about any existing venture financing? While it is usually the buyer's counsel who focuses on the title issues discussed above, in the author's experience, the debt tends to get the immediate attention of the buyer's business representatives. For example:

4.5.1 *Insufficient Leverage*. The *amount* of the existing financing may be insufficient to achieve (x) the buyer's target returns (which might be achieved with more positive leverage), or (y) the buyer's diversification goals (because it will require too much of an equity cash outlay). These problems may arise if, as is often the case, there has been appreciation in the property value or principal amortization since the venture was formed.

4.5.2 *Excessive Leverage*. On the other hand, the *amount* of the existing financing might be *too much* to achieve (x) an acceptable loan-to-value ratio for a conservative buyer, or (y) the minimum deployment of equity capital required by the buyer to make the investment worthwhile (as discussed in Section 4.6 below). While an excessive LTV may be less likely than an insufficient LTV, it is possible (e.g., the Property may have been acquired by the venture when the real estate market had peaked, as in 2007, for what turned out to be an unrealistic price).

4.5.3 *Unfavorable Repayment Terms*. The repayment terms of the existing financing may be unfavorable (e.g., an above-market interest rate) at the time of sale. It is also possible that the repayment terms will be favorable, but the selling member may not know at the time the venture is formed whether it will have an interest rate issue when it wants to sell.

4.5.4 *Required Consent and Loan Modifications*. The existing loan documents (x) may not permit internal transfers that the buyer requires, (y) may impose disclosure or other obligations that are not acceptable, and (z) may not permit the sale to the buyer without the lender's consent or without satisfying conditions that raise a question as to the certainty or timing of the sale. Will the lender provide any needed consent and modifications?

4.5.5 *Buyer-Specific Financing Issues*. There may be buyer-specific financing issues (e.g., a tax-exempt buyer may not be able to make the investment unless certain requirements are met, such as compliance with the so-called fractions rule,[33] which, as discussed in Section 4.2.2, could require an amendment to the LLC agreement).

Some of these problems could be solved by simply refinancing the debt. But it may not be possible or practical to refinance (e.g., because of a lockout, prohibitively expensive prepayment or defeasance costs, or simply because the continuing member does not agree). And although those buyers who want more debt might be able to find (and the existing lender and the continuing member might not prevent) mezzanine or unsecured financing to reach the aggregate level of financing the buyer wants, it will likely come at a cost that will translate into a lower price to the selling member.

4.6 Deal Size. A buyer may want to deploy a minimum amount of equity capital in any acquisition and the purchase of a membership interest may not require sufficient capital. This is not necessarily an issue of having too much debt (as discussed in Section 4.5.2 above) because the same buyer may also want *more* leverage to achieve its target returns (or the deal may be too small even unleveraged). In the case of a smaller asset that would be close to a prospective buyer's minimum equity threshold, acquiring a membership interest rather than the entire asset might be just enough to eliminate the deal from consideration.

5. GENERAL EXIT STRATEGY MATTERS

The Unilateral Sale Right, ROFO, Buy/Sell and Put/Call also have issues as exit strategies. Here are some common (or similar) elements and concerns for these alternative exit strategies and a description of whether and how they are addressed by the Sample Provisions:

5.1 Lockout Periods: When Is Exit Right Available? In some deals, the exit right is always available. However, more often than not, there is some initial lockout period of one or more years. For example, the members may want to allow time to complete the immediate objectives of the venture (e.g., completion of a development or renovation) before any thought is given to an exit. The Sample Provisions provide for a single, fixed lockout for an unspecified (blank) number of years. But there are many possible variations. Among other matters, a lockout period may not be a consecutive period of time (i.e., there may be an exit right during different periods that are not consecutive), the lockout periods may differ depending on the exit strategy, and the lockout periods for any particular exit may differ depending on the member.[34] One relatively common lockout period that is sometimes overlooked (but is addressed in the Sample Provisions[35]) is any period when another exit strategy is in process or while the venture is under contract (including a letter of intent) to sell the Property.

5.2 Length of Offer, Election, and Closing Periods. There are a number of time periods in these exit strategies once the process starts, including:

- the period of time to make the offer in the ROFO that requires the non-initiating member to make the offer;
- the election period in the ROFO and Buy/Sell;
- the closing period for the inter-member sale in the ROFO, Buy/Sell and Put/Call; and
- the closing period for a third-party Property sale in the ROFO.

The length of each of these time periods is negotiable and varies from deal to deal. The Sample Provisions provide for unspecified (blank) time periods that can be completed to reflect the agreement of the members. If a member is short on capital, it will often request longer offer, election and inter-member sale closing time periods to raise money in case it becomes a purchasing member. If a member is concerned that a prolonged process may adversely affect the Property or the exit strategy itself, it may request shorter time periods.[36]

5.3 What Is Being Priced or Valued? The Sample Provisions require a price or value for "the Property."[37]

- Some ROFOs, Buy/Sells and Put/Calls reviewed by the author require instead a price or value for "all the assets" of the venture. The difference between *Property* pricing and *all-asset* pricing is discussed in detail in the Hypothetical JV Sale Article and will not be discussed further here (except to note that if the venture has any assets that would not be sold to a third-party buyer, and ventures usually do, then it may not make sense to price those assets in a ROFO because the comparison required by the ROFO between the ROFO price and the third-party price may then be apples to oranges).[38]

- The Sample Provisions assume that the venture owns only one real estate project. What if that project is comprised of multiple components that may be sold separately (e.g., super-pads of residentially zoned land that may be sold separately to home-builders, a retail out-parcel that may be sold to a restaurant or bank, or simply excess land)? And what if, contrary to our assumptions, the venture owns multiple projects? In these circumstances, the exit strategies may become more complicated if they may be applied to less than all of the venture's real estate, as discussed in Section 5.4 below.

5.4 Multiple Property Deals. If the members in a multi-asset deal are using an exit strategy as a means of ending their relationship, then an all-or-nothing approach makes sense to ensure a clean break. However, the selling member under the Put/Call or the Unilateral Sale (and even the other member under a ROFO, if it doesn't want or is unable to buy) may be concerned that a bulk transaction could result in a discount because, among other matters, the venture's properties may be at different stages of development and the properties may be ready for sale (or may experience a peak or depression in value) at different times. One additional way to part ways that may avoid this problem is a division in which the members value each of the properties, then flip a coin and take turns selecting properties until one member gets within a certain range of its share of the values (and a final adjustment is then made in cash).[39] But if the members are otherwise getting along, then applying exit strategies to one or more (but less than all) properties may be feasible and the author has seen it done. If only a portion of the venture's properties (the "**Subject Property**") is to be priced or valued, then one member's acquisition of the entire interest of the other member in the venture (as in the Sample Provisions) may not make sense unless the proposed sale covers all of the properties then owned by the venture. Although partial sales are not addressed in the Sample Provisions, here are some potential solutions to the partial sale problem:

5.4.1 *Purchase of Portion of Membership Interest*. It is conceivable to have the purchasing member acquire only a portion of the interest of the other member. However, this approach tends to be too complicated if not entirely impractical. It may not be feasible to establish the portion of the interest to be sold or the appropriate impact, if any, on voting and management rights and promote or other distributions (or even the relationship of the value of the property being sold to the value of the property being retained). The author has not encountered this approach in practice.

5.4.2 *Purchase of Subject Property*. The exit may be structured so that the purchasing member purchases the Subject Property rather than all (or a portion of) the interest of the selling member. In the author's experience, this is a common solution to the partial sale problem. But there are a number of issues with this approach (most notably, the income tax consequences of selling to oneself).[40] If this approach is followed, it may allow for the possibility of a sale of the entire interest of the selling member when the Subject Property is all the remaining real estate of the venture.

5.4.3 *Purchase of Membership Interest in Sister Entity*. An alternative approach (intended to address the issues with the Subject Property sale) is to move the Subject Property to a sister entity and then allow the purchasing member to acquire the selling member's interest in the sister entity.

- If the Subject Property is held through a separate subsidiary (that owns no other real estate assets), then the venture could distribute the ownership interests in the subsidiary to the members (based on the relative proportions of the distributions that would be received from a hypothetical sale of the Subject Property), at which point (at least for an instant in time), the Subject Property would be owned by a sister entity. In this way, the members create a simple one-property scenario similar to what is assumed in the Sample Provisions. Then, the initiating member sells its ownership interest in the sister entity to the other member.

- Even if the venture does not have separate subsidiaries, it can create one to own the Subject Property by having the venture contribute the Subject Property to a new subsidiary and then follow the same procedure. However, the latter approach requires the recordation of a deed, which may have other consequences.

In either case, there are at least three complications to consider: (1) whether the procedure is permitted by the financing encumbering the Subject Property; (2) how the transaction is taken into account in the promote structure; and (3) potential transfer taxes. Each of these complications should be considered in advance: the release provisions in the loan documents should be negotiated to permit this procedure; the members may treat the distribution in kind of the ownership interests as distributions in the respective amounts of the hypothetical net sale proceeds each member would receive; and local transfer taxes and applicable exemptions should be understood and addressed (including the apportionment of responsibility among the members) as appropriate.

5.5 ***How*** **Is the Property Priced?** In all of the exit strategies in the Sample Provisions, it may be difficult to know the true value of the Property. If a member has the time and the opportunity to gather market information, it may feel protected, but in the author's experience, this apparent protection is often illusory.

5.5.1 *Pricing Risk.* Appraisals, broker opinions of value (BOVs) and other valuation assessments may be helpful in reducing the pricing risk associated with exit strategies. But there is no substitute for the actual marketing of the Property when the seller has both the desire and the right to sell.

- In the Unilateral Sale subject to the ROFO, this issue may be mitigated for the initiating member by the variant of the ROFO that requires the non-initiating member to make the offer: the initiating member may reject the offer and then test the market.[41]

- In the Buy/Sell, the risk may be even greater because it does not allow the market to be tested in any meaningful way.

- In the Put/Call, the members usually rely on a valuation procedure (e.g., a three-appraiser process that may or may not end with baseball arbitration or some kind of averaging of 2 or 3 of the valuations). Sometimes the members get lucky and the resulting price is pleasing to everyone. But valuation procedures may lead to disappointment for one or both of the members. For example: with baseball arbitration, there is only one winner and no guaranty that the arbitrator will make the correct choice (or that the winning party will not feel compelled to propose what might otherwise be an unsatisfactory value to avoid losing); and with regular arbitration, the arbitrator may "split the baby" in the spirit of compromise, leaving both parties unsatisfied.

5.5.2 *Informational Disadvantage*. One of the members may feel that its pricing risk is exacerbated by the fact that it does not understand the market as well as the other member. Some institutional investors feel this way in relation to their local operating partners.

5.6 Addressing the Informational Disadvantage. The author has seen different approaches to address the informational imbalances identified in Section 5.5.2.

5.6.1 *Shifting Pricing Risk*. Some institutional investors try to shift the pricing risk to the operating member in the ROFO and Buy/Sell:

- In the author's experience, the variant of the ROFO that requires the non-initiating member to make the offer became popular among some institutional investors only after they discovered that they had underpriced property under a ROFO and walked away from substantial profits they might have shared. Some of these investors went so far as to require the operating member to make the offer regardless of who triggered the unilateral sale right (in deals in which both members had a unilateral sale right subject to a ROFO).

- The author has even encountered deals in which this asymmetric approach has been taken in a Buy/Sell. However, unlike a ROFO, where the failure of the non-initiating member to name a price within the requisite time period may lead to the best possible result for the initiating member (namely, no floor price), the failure of the non-initiating member to name a price under the Buy/Sell leaves the members in limbo (so additional provisions are necessary and the possible approaches are seemingly endless).

5.6.2 *Sharing Profits from a Flip*. So-called "schmuck protection" may be used to protect the selling member from unwittingly selling its interest to the other Member at too low a price: the selling member receives a share of the profits if the property is flipped at a higher price within a certain period after the inter-member sale.[42] However, this protection deals only with what may be the most embarrassing of mistakes—the quick flip at a higher price by the other member. In the author's experience, this approach is not common, and does not include any corresponding sharing of losses (i.e., schmuck protection is used only to protect a member from selling at *too low* a price and not to protect a member from buying at *too high* a price—a problem that could be equally problematic, but the solution to which would be harder to sell, craft, monitor and implement). The Sample Provisions do not include this protection.[43]

5.6.3 *Good Faith Estimates*. An approach that addresses the problem only when the member with the informational advantage is naming the price is to require good faith estimates of value.[44] But this approach adds another detail that the members can fight about (which may interfere with the more important goal of having a clean exit). Indeed, some members instead may want to make it clear that the price need not have any relationship to fair market value to avoid second-guessing.[45]

5.6.4 *Disclosure Obligations*. Some practitioners rely on contractual, statutory or common law disclosure obligations.[46] Sometimes specific disclosure obligations are added to the exit strategy (e.g., to identify discussions with third parties regarding a sale of the Property).[47] However, members may resist fiduciary obligations and, to avoid potential obstruction of the exit, may prefer to have each member fend for itself.[48]

5.7 Deposit for Inter-Member Sale. If the exit strategy results in an inter-member sale, a deposit is often required and, as in the Sample Provisions, it is often some percentage of the purchase price of the selling member's interest. When there is a deposit requirement, the deposit generally must be posted by the time (or within

a fixed number of business days after) there is a binding obligation to proceed with an inter-member sale. It is possible to require the deposit sooner, as a condition to the *effectiveness of an offer* to purchase:

- The Buy/Sell is sometimes drafted to require a deposit *even before* the identity of the purchasing member is determined. Thus, a deposit may be required at the same time as (and as a condition to the effectiveness of) the triggering of the Buy/Sell to make sure the member who starts the process is serious (but with the understanding that the deposit will be refunded if the initiating member does not turn out to be the purchasing member).

- Similarly, although the author has not encountered this approach, when the ROFO requires the non-initiating member to make the offer, it is possible to require, as a condition to the effectiveness of the offer, that the deposit is posted simultaneously.

As is sometimes done in contracts for the purchase and sale of real estate, some LLC agreements require, in one or more of the following circumstances, that the deposit be posted at the time of, and as a condition to, the *effectiveness of the agreement* to proceed with an inter-member sale:

- In the variant of the ROFO in which the initiating member makes the offer, the non-initiating member may be required to post the deposit at the time it accepts the offer;

- In the Buy/Sell, when the non-initiating member elects to purchase, it may be required to post the deposit at the time of its election; and

- In the Put/Call, when the purchasing member is the initiating member, it may be required to post the deposit at the time it triggers the Put/Call.

But simultaneously posting the deposit (at the time of the notice that would otherwise create the inter-member sale contract) obviously does not work when that notice comes from the member who is not posting the deposit (i.e., the selling member).[49]

The Sample Provisions do not require delivery of the deposit *before* or *at the time of* the notice that would otherwise establish a contract for the inter-member sale. Instead, the Sample Provisions allow five (5) business days after that notice is given,[50] which is an approach that can work for the ROFO (both variants), Buy/Sell and Put/Call.

5.8 Loss of Exit Rights. The members should consider whether and under what circumstances a member should lose any of its exit rights. The Sample Provisions do not contain provisions that eliminate exit rights, although such provisions may appear elsewhere in the venture agreement.

5.9 Interaction with Other Venture Provisions. Even when there is reciprocity in the exit strategies (as in the Sample Provisions), each member should consider the interplay between the exit strategies, on the one hand, and the other terms of the LLC agreement, on the other hand. There might be inconsistencies or potentially undesirable consequences that are not addressed by the Sample Provisions.[51]

5.10 Interaction with Loan Documents and Other Third-Party Contracts. Whatever exit strategies are chosen, they may not be of much use if they are not permitted by a venture loan document, ground lease or other third-party contract. The members should try to negotiate with the venture's lenders, ground lessors and other counterparties to allow the exit strategies contemplated by the LLC agreement. If the LLC agreement is finalized before a loan, ground lease or other contractual arrangement is established, then at the time of such future contracts, the members should consider whether any changes to the LLC agreement are appropriate in light of the manner in which the new contracts address the exit strategies.

5.11 Tax-Free Exchanges. Sometimes a member may want the flexibility to restructure a sale or purchase under the applicable exit strategy as part of a tax-free exchange. This subject is discussed in Appendix B to this article.

6. UNILATERAL SALE PROVISIONS

A right to cause a sale of the Property is generally the most favored exit strategy for a member to liquidate its investment: for the reasons discussed in Section 4 above, a sale of the Property may result in more profit to the initiating member than a sale of a membership interest; and a fully marketed Property sale is likely to yield a more reliable price than one obtained by appraisal or other means. But other provisions, especially the ROFO, may come into play that condition or otherwise limit the unilateral sale right. This Section will discuss some of these limitations and certain other provisions that govern the unilateral sale right.

6.1 Timing: To What Extent May Sale Process Precede ROFO Process? May a member with a unilateral sale right commence the sale process (e.g., marketing) before the ROFO process is commenced? Not necessarily. The answer is inextricably tied to the terms of the ROFO (in addition to the wording of the other limitations on its sale right).

6.1.1 *When Initiating Member Makes the Offer*. First, consider the variant of a right of first offer that requires the initiating member to make an offer. What sales activity, if any, may occur before the initiating member must make an offer?

(a) Until Desire or Decision to Sell? Is it conceivable that no sales activity is permitted before the ROFO process? Indeed, it is possible that the ROFO is triggered (and an offer must be given) at the very moment when the initiating member "desires" or "decides" to sell. The reference to a desire or decision may be dangerously vague,[52] but these words appear in many ROFOs.[53] And some cases (which are outside the venture context and therefore refer to an "owner" or "seller" rather than an initiating member) suggest that they reflect the appropriate trigger:

> [A] right of first offer is triggered when the owner decides to offer the property for sale . . . .[54]

However, such statements should not be taken out of context. The above quote is from a case involving a variant of a ROFO under which the price and terms were set in advance.[55] Under such circumstances, a court might find evidence (e.g., a listing agreement) of the mere intent to sell to be sufficient to trigger the ROFO.[56] But typically (in the author's experience and in the ROFO cases reviewed by the author), the ROFO is merely *conditioned* on a "desire" or "decision" to sell. And even when viewed as a potential trigger, courts have allowed appraisals, listing agreements, marketing, and even negotiations,[57] in apparent (and sometimes explicit)[58] recognition of the notion that a meaningful decision to sell does not necessarily arise until an acceptable price (or pricing mechanism) has been established. In the author's experience, many real estate professionals assume that a ROFO is not triggered when a "desire" or "decision" condition is satisfied and will not be triggered until they actually give notice (as long as they don't close a sale with someone else beforehand). As one court put it:

> [W]hen properly construed this provision does not require that Seller's Notice be given upon the formation of a desire to sell the [property], or even when [Seller] affirmatively decides to sell the property.[59]

Such real estate professionals are well advised to avoid language (e.g., "When a member desires to sell the Property, it shall give notice . . .") that indicates otherwise.

(b) "First" Offer: Before Making Other Offers? But does the plain language of the ROFO preclude offers to third parties before going through the ROFO process? In other words, based on a literal interpretation of the term "first offer," must the offer under the ROFO in fact be the "*first*" offer made? Although the author is not aware of a universally accepted practice that adopts this approach, the Delaware Court of Chancery in an unpublished opinion (outside the venture context) suggests it is firmly established:

> In the real estate industry, "[a] right of first offer . . . obligates the owner to offer the property to the [right-holder] before offering it to any third party.[60]

This case does not offer much case law support for this statement,[61] but it is not the only case to reach this conclusion. According to a book cited in at least two ROFO cases:[62]

> The owner is required to *first offer to sell* the property *to the holder of the right of first offer* before offering the property for sale to anyone else.[63]

This book cites no authority for this proposition other than a case that cites the book itself. Given the confusion in this area of the law (as discussed below in Section 7.1), caution may be warranted if a party expects to deviate from this seemingly intuitive notion of priority under a right of "first" offer.

(c) What About Conditional Offers ("subject to" the ROFO)? But what about an offer that is subject to compliance with a ROFO? A party granting a ROFO may assume that it has the right to accept an offer and enter into a sale agreement as long as it is subject to the ROFO. However, at least two courts have found otherwise.[64] In one of those cases,[65] the ROFO stated that "[i]f at any time . . . Owner desires . . . to sell the Property . . . , then prior to . . . Owner . . . effecting a sale to a third party . . . Owner . . . shall first give . . . notice thereof . . . ." The owner (i.e., the grantor of the ROFO) argued that this language obligated the owner to send notice any time before "closing" a transaction with a third party. But the court found that the word "effect" is different from the word "close" and once the owner decided to sell the Property on certain terms, the owner was obligated to give notice:

> When [the owner] decided to sell presents a question of fact. [The owner] was entitled to test the market to inform himself about whether to sell and on what terms. He could explore potential transactions and possible structures with third parties. But once he decided to sell the Property and knew the price and structure, [he] was obligated to send the [notice] before proceeding further with a third party.[66]

By entering into an agreement with a third party, the court found that the owner had proceeded too far (even though the agreement was subject to the ROFO):

> [The owner] had made the decision to sell the Property [when it entered into an LOI with a third party]. He breached the ROFO Agreement by not sending the Property Offer Notice at that point . . . . Under the terms of the ROFO Agreement, the [owner was] obligated to send [the holder] a Property Offer Notice first, before taking substantial steps to bring about a transaction with [a third party]. [The owner] breached the ROFO Agreement by failing to give [the owner] notice first and by taking virtually every step to conclude a transaction with [a third party] short of closing before sending the Property Offer Notice.[67]

However, this case may have limited, if any, precedential value. The decision is a result-oriented unpublished opinion involving an unsympathetic owner who seemed intent on depriving the holder of the benefits of the ROFO to avoid, among other matters, paying the breakup fee he had agreed to pay his third-party buyer if the ROFO holder

elected to buy (by, among other matters, stating a price equal to roughly 103% of the price it had already negotiated with the third party). The second case also has limited value due to its facts: it involved a ROFO variant granting a first right to purchase a membership interest under a pre-agreed pricing mechanism (so that notification of terms was not required, simply the intent to sell).

(d) Other ROFO Restrictions. Some ROFOs involve express limitations on certain sale activities prior to commencing the ROFO process, such as entering into a listing agreement, or making an offer to, or entering into negotiations with, a third party.[68] However, in one such case (requiring an offer before offering or listing the property for sale), the court found "solicitation of offers from, and negotiations with, prospective third-party purchasers" did not violate, and were not sufficient to trigger, a ROFO.[69]

6.1.2 *When Non-Initiating Member Makes the Offer*. What would happen if a ROFO requires the holder of the ROFO to make the offer to the owner? The author is unaware of any cases addressing this variant of the ROFO. Would a court conclude that the owner is required to give the holder the *first* opportunity to make an offer (and therefore must trigger the process before soliciting any offers from third parties)? Such a conclusion would leave little room, if any, for testing the market before ROFO process.

6.1.3 *Sample Provisions*. The Sample Provisions require the ROFO process to start before "consummating" a sale.[70] In a business context, the verb "consummate" means "finish" or "complete."[71] But query whether a "right of *first* offer" is a misnomer if the parties intend to allow the initiating member to make and solicit offers subject to the non-initiating member's rights? In such circumstances, it might be clearer if the provisions simply referred to a right to make or receive an "offer" rather than a "*first* offer." Although the author is aware of many agreements that merely allow for an offer and not necessarily a *first* offer (with the understanding that no closing is permitted without going through the process with the holder of the right to receive or make the offer), the author does not recall encountering any deviation from the right of *first* offer terminology. For clarity, the Sample Provisions add a parenthetical clause stating that the ROFO process must start prior to the execution of a purchase agreement unless it is expressly subject to the ROFO (so that "first" still has meaning in terms of priority but does not preclude earlier offers).

6.2 Timing: When Must Sale Process End? There is usually a limited period of time (after the ROFO election period) during which the sale of the Property must be consummated. In the author's experience, it typically ranges from six to twelve months after the election period under the ROFO.[72] Too long a period may render the originally offered price stale (and the non-initiating member may want the price to be reset), but too tight a time frame may exclude some potential buyers from the process. It is possible to provide for an extension of the closing period if a buyer has executed a purchase agreement during the original closing period. It is also possible to break the closing period into parts with one period for the signing of a contract and then another period for the closing of the sale. Neither of these options is addressed in the Sample Provisions.[73]

6.3 Who May Buy? Perhaps the most common limitation on a unilateral sale right is that the initiating member may not sell to an affiliate (without the non-initiating member's consent). The purpose of this limitation is usually to prevent self-dealing: the non-initiating member doesn't want the initiating member and its affiliates to be on both sides of the transaction (and then through what might be a below-market sale, keep for itself some of the venture's profit that should have been shared). But what about the non-initiating member who holds the ROFO? Some real estate professionals also want to make sure that the non-initiating member and its affiliates are not on both sides of the transaction. Why? Even in the absence of any wrongdoing, having an affiliate of either member in the buyer pool may result in a lower price due to reduced market interest. Indeed, some potential buyers may not want to compete with an insider because of perceived disadvantages due to the insider's:

- superior knowledge of the asset;
- lower investigative costs;

- greater ability to close quickly;
- greater willingness to accept fewer representations and other legal protections; and
- stronger and more tested relationship with seller.

Yet it is surprisingly common, in the author's experience, for a member (who doesn't want to sell) to retain an interest in the Property by teaming up with the buyer. The Sample Provisions require consent to any sale to an affiliate of *either* member by the unaffiliated member.[74] But query whether the venture gets the benefit of a fully marketed sale even if a member is merely talking to potential buyers about staying in the deal? If this is a concern, provisions can be added prohibiting each member and its affiliates from having *or seeking to have* a direct or indirect interest in the buyer.[75] Of course, depending on how the LLC agreement is drafted (and whether or not fiduciary duties can be and have been eliminated), there may be other limitations on self-dealing.[76]

6.4 Amount of Purchase Price. The ROFO may establish a minimum price for a third-party sale that may make it difficult to attract potential buyers. This problem may be mitigated in several different ways.

6.4.1 *Margin of Error*. Typically, the initiating member is given some latitude to reduce the price in recognition of the fact that the ROFO pricing may not reflect the market. The permissible margin of error varies from deal to deal (depending on, among other matters, the asset and the magnitude of the dollars involved). In the author's experience, the margin typically ranges from 1% to 5%.[77] The Sample Provisions include an unspecified (blank) percentage.[78] There is sometimes greater resistance to the margin of error when the non-initiating member is making the offer because it is taking the pricing risk. The author has encountered some parties who have suggested that if the non-initiating member makes the offer, then it should get the benefit of the margin of error by requiring a floor price that is *more* than 100% (e.g., 102%). However, the author does not recall seeing this approach implemented in practice. Regardless of who names the price, there is still the possibility that issues may arise that reduce the price after a contract is signed. In fact, price reductions resulting from matters discovered during due diligence are relatively common. If the parties want to limit the initiating member's flexibility to sell at a lower price, they may consider allowing all or a portion of the permissible reduction in the purchase price only for adjustments occurring after the purchase contract is effective.[79]

6.4.2 *Restarting Process on Expedited Basis*. Another way the initiating member may get relief from the floor price requirement is to have the right to restart the ROFO process (at a lower price) on an expedited basis for a limited period of time, while everything is still fresh (so that the non-initiating member will be able to respond quickly).[80]

6.4.3 *Making the Non-Initiating Member Whole*. Yet another approach is to give the initiating member the option to pay the non-initiating member the shortfall resulting from a sale at a lower price (so that the non-initiating member gets the same amount it would have received from a sale at the floor price).[81]

6.5 Manner of Payment: All Cash vs. Loan Assumption. The Sample Provisions contemplate an all-cash price. They do not permit the initiating member to sell subject to existing mortgage financing unless a loan assumption is approved as a major decision. Prohibiting a loan assumption may eliminate or reduce ROFO issues. But it may also limit the times when the Property may be sold.

6.5.1 *Allowing Assumption During Prepayment/Defeasance Lockout*. It is possible to allow a sale subject to the debt during the prepayment/defeasance lockout period and otherwise require an all-cash sale. This would require changes to the Sample Provisions.[82]

6.5.2 *Allowing Assumption at Any Time*. If the debt may be either eliminated or retained, then the difference between the cost of *elimination*, and the cost of *retention*, of the debt (which is often substantial) may make it difficult to have a meaningful comparison of the ROFO price and a third-party price.[83]

(a) Company Prices Net of Costs. One solution to this problem is to compare prices that are net of these costs (to the extent payable by the seller). But even using net prices may be challenging: there is a risk of both (1) a bad estimate (in naming the net price); and (2) an argument over what actual costs should be deducted in calculating the net price paid by a third-party buyer. Moreover, by using net prices, the purchasing member may be getting all the hypothetical loan assumption/satisfaction cost savings that occur in an inter-member sale.[84] To minimize the calculation challenges, it may be helpful to specify more precisely the costs involved. For example, one might limit the applicable costs to the prepayment, defeasance or transfer and assumption costs payable to or on behalf of the lender.

(b) Having Buyer Pay Costs. Of course, there are no costs to deduct if the costs are paid by the buyer. Thus, another approach encountered by the author is to require that the purchase agreement impose the relevant costs on the buyer.[85] While this approach appears to result in a more manageable comparison, will it result in a deflated price? Will the buyers who want to eliminate the existing debt be willing to take the time to understand the loan satisfaction costs in order to bid a net price (and if they decline to participate, will there be less competitive bidding and will that translate to lower pricing)? Even if a buyer is willing to name a net price, will it be willing to take the risk of variable costs (e.g., uncertain defeasance costs) or will it name a conservative, artificially low price by assuming the maximum possible costs?[86] And if there is likely to be a deflated price, will the initiating member (in the variant of the ROFO in which it must make the offer) be able to proceed or get as many bidders to participate (in light of the minimum price requirement imposed by the ROFO) without naming a bargain price at the outset?[87]

(c) Choosing Alternative. It is, of course, cleaner to use (as is done in the Sample Provisions) an all-cash sale because it makes it less likely there will be a dispute over exactly what costs should be paid or deducted. But this means no sale during any prepayment/defeasance lockout period. If a loan assumption is allowed as an alternative, consider whether a choice must be made by the initiating member when the process begins.

6.5.3 *Loan Assumption Right and Process*. If the members want the unilateral sale provisions to allow a loan assumption, they should negotiate for this right in the loan documents:

- *with* such a right, it is usually just a question of time to complete the loan assumption (although it is possible the conditions to loan assumption might not be satisfied); whereas

- *without* such a right, the likelihood of success may be difficult to assess (and some members may not be willing to allow such a sale subject to the debt as a possibility under the unilateral sale provisions).

In either case, depending on the lender and the loan assumption provisions in the loan documents, if any, the time to complete a loan assumption may vary significantly. The initiating member may want the right to extend the closing date (up to an outside date) to allow sufficient time to obtain the consent of the lender and complete the assumption process. The members may also want to address whether there should be a condition to closing that the existing guarantors are released from future liability under the loan guaranties (although some buyers may want the right to provide indemnification in lieu of a release if the lender does not provide such a release).[88]

6.6 Other Terms of Sale. Many ROFO provisions require that the first offer notice specifically address other *economic* or *material* terms of the proposed sale and sometimes *any other* terms of the proposed sale.[89] However, when the initiating member makes the first offer, this approach may result in claims by a recalcitrant

member that the initiating member's notice was missing something and was therefore not effective.[90] And in some transactions, the member making the offer may be tempted to include terms that make it difficult for the other member to accept.[91] Regardless of who gives the first offer, the initiating member wants to minimize disputes over whether it sells to a third party on the same or better terms, and the recipient of the offer wants to avoid terms that create a disadvantage. Here, it would seem that less is more. The Sample Provisions take the approach of specifying nothing other than an all-cash purchase price.[92] But what about the other terms of a sale to a third party? To what extent should the initiating member have the right to establish these terms? There is a wide spectrum of possibilities. For example, the members may want to treat the details of the sale (e.g., the form of purchase agreement) the same way they treat other major decisions. Sometimes express limitations may be imposed on approvals or on the initiating member's discretion (e.g., reasonableness or good faith). The Sample Provisions give the initiating member discretion and impose a good faith standard on its discretion. Sometimes the initiating member may be given broad leeway to cause a sale of the Property and the matters incidental to the sale subject to the price limitations of the ROFO. However, even then, applicable law (e.g., the implied covenant of good faith and fair dealing) may nonetheless impose constraints to defeat bad-faith manipulation by the initiating member (by, for example, colluding with a third-party buyer to make an offer requiring the seller to pay all closing costs, including those customarily paid by the buyer, so that the buyer can state an artificially high price that exceeds the minimum price established by the ROFO).[93]

6.7 Authority. There are often few provisions in the LLC agreement expressly devoted to the authority of the initiating member to effectuate the sale of the Property. But evidence of authority to execute documents may be needed to satisfy the buyer and the title company (if the initiating member is the sole signatory of the sale documents). In the author's experience, there is no single approach that is commonly utilized when the issue of authority is addressed. The Sample Provisions state that the initiating member has the authority to execute documents alone on behalf of the venture, and that third parties may rely on such execution as conclusive evidence of authority; but, as between the members, the initiating member may unilaterally sign documents only as long as they are consistent with the unilateral sale provisions.[94] Other approaches include running everything through the major decision process or requiring both members to sign the sale documents.

7. ROFO

7.1 Preferential Rights Generally. In the author's experience, rights of first offer are the most disputed, and the most difficult to implement, of all the exit strategies discussed in this article. The cases regarding these rights and other similar preemptive or preferential rights ("**Preferential Rights**") do not paint a pretty picture. They reflect widespread confusion and misunderstandings at all levels. As observed by Corbin in his chapter on options and rights of first refusal:

> All of the terms discussed in this chapter have had variable and inconsistent usages. People use them—lawyers and judges as well as business people, workers, preachers and professors—variably and inconsistently.[95]

And Preferential Rights have continued to expand to take on new meanings and variations, including various rights of first offer and rights of first negotiation. They typically include the following features:

- **Right of First Refusal (ROFR)** – a right to match a bona fide third-party offer the owner is willing to accept.[96]

- **Right of First Offer (ROFO)** – a right to make or receive an offer, which may establish a floor price if the offer is not accepted.[97]

- **Right of First Negotiation (ROFN)** – an exclusive right to negotiate for a certain period of time.[98]

In light of the myriad of ways Preferential Rights may be perceived and drafted, the author cautions against preconceived notions about what these rights are or how they operate. For example, Preemptive Rights do not always involve a "grant by the owner of an interest in the subject property . . . of a right to acquire an interest in the property."[99] This may be obvious in the case of a ROFN (which may grant only a right to negotiate). But it is also true for the variant of the ROFO in which the holder makes the offer (which may grant only a right to make an offer and establish a floor price). And there are many variations, including ROFOs that don't establish a floor price (especially when the price to the holder of the ROFO is fixed in advance[100] or established by appraisal or other valuation method).[101] Another potential source of confusion may arise from the fact that the ROFO or the ROFR or both (unlike the Buy/Sell and the Put/Call) are very common in *other* real estate transactions (i.e., real estate transactions that do not involve ventures), including commercial leasing, land sales (especially those involving home-builders), and common interest communities (especially with residential condominium and cooperative associations who want strict controls over new owners). It may be a mistake to assume that the practices in those other areas of real estate apply equally in the context of a real estate venture between a sophisticated investor and operator/developer.[102] For example, *rights of first refusal* continue to be used in the world of leasing,[103] in lot sales by land developers to home-builders,[104] and in common interest communities (e.g., residential cooperative and condominium associations),[105] whereas, at least in the author's experience, they have all but vanished from real estate venture transactions involving a sophisticated investor and operator/developer (other than an occasional reference at the letter of intent stage that is superseded in the final documents).

7.2 ROFO as Compromise. The ROFO may be viewed as a compromise between the holder's desire for an option and the desire of the grantor (the party granting the ROFO) for complete freedom to transfer. On the one hand, the right of first negotiation is not favored by the holder because it has no assurance it will make a deal and if it doesn't, the grantor typically has no restrictions on its ability to sell.[106] On the other hand, options and ROFRs are not favored by the transferor because they impose too many restrictions on the owner's ability to sell and may make it difficult, if not impossible, to achieve the level of market appeal and competitive interest one might have without a ROFR (or an option).[107] It is theoretically possible to mitigate the chilling effect on the market by offering the buyer a breakup fee if an option or ROFR is exercised. But some potential buyers may not want to participate even then (especially if there are multiple bidders and investigation and legal costs must be incurred to get to the point where the breakup fee is assured). The fewer interested parties there are, the less competition, which may translate to a less favorable third-party transaction.[108]

7.3 ROFO – Who Makes the Offer? Not surprisingly, there is no single meaning of a "right of first offer." The term is ambiguous, primarily because it is not clear whether the holder of the ROFO is entitled to *receive* or to *make* the offer. In other words, *who* makes the offer? Is it the party who grants the ROFO (who wants to sell) or the holder of the ROFO (who wants the right to buy)? Each alternative is addressed in the Sample Provisions.

7.3.1 *Holder Receives the Offer*. Many real estate attorneys insist that a true ROFO requires the owner to give the notice so that the holder receives the offer. As one author put it:

> Though confusion abounds on the real meaning of a right of first offer (ROFO), most practitioners [representing the ROFO holder] would like to believe that a ROFO obligates the optionor to offer the asset to the ROFO holder before offering it to a third party . . . .[109]

Admittedly, there is much support for this view in the literature, especially in the context of leasing.[110]

7.3.2 *Holder Makes the Offer*. However, this interpretation is not universally accepted. Indeed, other authors suggest that the holder is or may be the one who makes the offer.[111]

7.3.3 *Dueling Approaches*. The fact is that both approaches are described by commentators and, in the author's experience, both are used in practice in the venture context. One author has observed:

> While the practice literature commonly refers both to the grantor offer structure and to the holder offer variation of the ROFO, I found it interesting that all of the recent ROFO cases I reviewed involved ROFO provisions that required the grantor, not the holder, to make the offer . . . .[112]

Query whether this observation is support for the hypothesis that the ROFO variant in which the holder makes the offer is used less in practice? Perhaps. But might it instead (or also) be evidence of the hypothesis that this type of ROFO is less likely to give rise to a dispute? This ROFO variant arguably limits holders' attempts to use the ROFO as a means to extract something or simply to obstruct or delay a sale: it is relatively easy in the author's experience for a holder to make claims that an offer from the grantor is improper; but it seems much more risky (and therefore less likely) for a holder to make an offer if the holder is not serious about buying (and if there is no offer, then there may be nothing to dispute).

7.3.4 *Making the Choice*. The problem for the initiating member in making the offer is that the initiating member may never get to the market to determine the true value of the Property. Without reliable market information, the initiating member walks a tightrope – trying to balance to avoid bad results that could result from leaning too far in either direction: if it mistakenly names a price that turns out to be too low, then the non-initiating member may grab the opportunity to buy at a discount (and this result may be more likely if the non-initiating member has better information about the Property); and if it tries to protect against selling cheap by naming a price that turns out to be too high, then it may not get any interest from third-party buyers. On the other hand, the non-initiating member may object to making the offer, because it does not have any assurance that it can prevent the sale and acquire the Property. It may be assured only that it will be able to set a floor price.

(a) Other Real Estate Transactions. In real estate transactions generally (outside the context of venture transactions), the more common approach, in the author's experience, is for the grantor to make the offer. This approach may make sense in the context of leasing (where the landlord is the one typically quoting leasing rates and likely has a better sense of the building) and lot sales by land developers to home-builders (where the home-builder gives the land seller a ROFO that applies if the home-builder wants to sell a lot without building a home on it). In both those situations, the holder of the right has typically bargained for a right to lease/acquire the property (so that the transferor's freedom to transfer has consciously been subordinated to the need of the tenant or the seller to have a right to lease or acquire the property upon the transferor's terms).

(b) Venture Transactions: Choosing Acquisition or Disposition Goal. In the context of a venture, however, the members should consider which is more important: a meaningful *disposition* right or a meaningful *acquisition* right. If an *acquisition* strategy is paramount, then they may choose to have the initiating member make the offer. However, if a *disposition* strategy is more important, then they may choose to have the non-initiating member make the offer (or not have a ROFO at all).

(c) Venture Transactions: Competing Goals. When the members have opposite goals, whether and what ROFO is chosen may simply depend on who has more bargaining power.[113]

8. BUY/SELL

Opinions regarding the benefits and risks of a buy/sell vary widely. Some real estate professionals refuse to do a real estate venture without a buy/sell and others refuse to do a real estate venture with one. Not all opinions regarding buy/sells are so extreme, but there is no shortage of different views. The general discussion in Section 5 above and the Hypothetical JV Sale Article touch upon many, if not most, of the concerns usually considered when

drafting buy/sell provisions.[114] But one point, which is raised in Appendix B of the Hypothetical JV Sale Article, is worth repeating. If the ultimate goal of the members is to have a mechanism that will allow the members to part ways with the minimum potential for disruption, then consideration should be given to a buy/sell formulation that simply states a net number to be run through the distribution waterfall to determine the pricing (without any prorations or other adjustments). While there may be risks with such an approach (which may grow with the time between pricing and closing), maximizing certainty comes at a price. For some members, it may be worth it.

9. PUT/CALL

In the author's experience, puts and calls are relatively rare in real estate ventures except under special circumstances (e.g., a right to call the interest of a defaulting member, a right of a member to put its interest upon the failure to meet certain crucial requirements upon which the venture was based, or a put or a call or both in some debt investments disguised as preferred equity). In particular, a put/call is often reserved for those circumstances where the members know in advance that one member wants to be a seller and the other member wants to be a buyer, and therefore they agree that the latter member will purchase the former member's interest at the election of either member (when certain conditions have been met). Depending on the circumstances, the terms of the put/call (and the conditions that trigger it) may vary considerably. Further details are not provided in this article due to space constraints.

10. FINAL MESSAGE

The final message of this article is that the members of a venture should take the time at the outset to find exit strategies that are tailored to fit their needs given the relevant facts. This article sets forth some alternative exit strategies, any of which may require modification for that purpose. In most transactions, it is unlikely that all of these exit strategies will be desired or appropriate. For example, in a transaction in which the members agree that they should part ways by one particular member purchasing the interest of the other member, then only the Put/Call may make sense. There may also be circumstances calling for a special exit strategy that differs from any of those discussed in this article. Consider, for example, a situation in which each member wants the right to become the sole owner of the Property at some point. Clearly, the Unilateral Sale, Buy/Sell or Put/Call would not fit well in those circumstances. Instead, the members might have an auction in which the members submit sealed bids or they bid alternately with minimum incremental increases until the highest bidder wins the right to buy the other member's interest. Similarly, if each member wants the right to dispose of its interest quickly without taking the time to market the property (and sell to a third party), then they might have a so-called Dutch auction in which they submit sealed bids or they bid alternately with minimum incremental decreases until the lowest bidder wins the right to sell to the other member. The number of possibilities is legion.

* * *

APPENDIX A

SAMPLE EXIT STRATEGY PROVISIONS

This Appendix sets forth sample (not necessarily model) provisions for:

- a reciprocal unilateral right to sell the Property (§ 12.1);
- a ROFO (§ 12.2);
- a Buy/Sell (§ 12.3);
- a Put/Call (§ 12.4); and
- consolidated inter-member sale provisions (§ 13) that are intended to apply whether the inter-member sale arises from the exercise of the ROFO, Buy/Sell or Put/Call.[115]

These provisions are based on the assumptions described (see TERMINOLOGY AND ASSUMPTIONS) at the outset of the body of this Article. Some optional provisions appear at the end of this Appendix.

Section 12. **Certain Exit Strategies**.

* * *

UNILATERAL SALE

12.1 Unilateral Sale Rights. At any time or times during the "**Unilateral Sale Exercise Period**" (i.e., the period from and after the ___ anniversary of the date of this Agreement),[116] either Member[117] (the "**Unilateral Sale Initiating Member**") shall have the unilateral right without the consent of the other Member (the "**Unilateral Sale Non-Initiating Member**") to cause the Company to sell the Property[118] upon and subject to the following terms and conditions:

12.1.1 *ROFO*. Prior to consummating the proposed sale,[119] the Unilateral Sale Initiating Member shall have commenced the process under Section 12.2 (Right of First Offer) and a timely "ROFO Election" (as hereinafter defined) shall not have been made.

12.1.2 *Closing*. The closing of the proposed sale must occur prior to the expiration of the __-month period[120] (the "**Unilateral Sale Closing Period**") that commences on the first business day after the "ROFO Election Period" (as hereinafter defined). However, the Unilateral Sale Initiating Member may terminate the Unilateral Sale Closing Period by written notice to the other Member at any time as long as the Company is not then subject to a binding agreement to proceed with a sale of the Property.

12.1.3 *Affiliates*. No sale of the Property shall be made to an Affiliate of a Member without the prior written approval of the other Member.[121]

12.1.4 *Amount of Purchase Price*. **[ROFO 1:** If there is a "First Offer Notice" (as hereinafter defined), then**]** any such sale must be for a purchase price not less than ___%[122] of the ROFO Property Price (the "**Minimum Required Sale Price**").

12.1.5 *Manner of Payment*. The purchase price for the Property shall be payable entirely by wire transfer of immediately available federal funds[123] at the closing of the proposed sale unless an assumption of the Project Financing is approved as a Major Decision.[124]

12.1.6 *Other Sale Terms*. The other terms of the sale shall be determined in the good faith judgment of the Unilateral Sale Initiating Member, including the forms of the purchase agreement and the closing documents.[125]

12.1.7 *Authority*. The Unilateral Sale Initiating Member shall have the authority to execute documents as the sole signatory on behalf of the Company in connection with the marketing and sale of the Property, and third parties may conclusively rely on any document signed by the Unilateral Sale Initiating Member on behalf of the Company as being duly authorized without further inquiry. However, as between the Members, nothing herein shall waive or otherwise limit the Unilateral Sale Initiating Member's liability for a breach of its obligations if it executes a document that is not consistent with this Section 12.1.[126]

* * *

ROFO

12.2 Right of First Offer. **[**Note: These provisions include two alternatives:**[127] **ROFO 1**: *Non-Initiating Member* makes offer; and **ROFO 2**: *Initiating Member* makes offer.****]**

12.2.1 Commencing ROFO Process. Prior to consummating a proposed sale of the Property (and prior to executing a purchase agreement, unless it is expressly subject to this Section 12.2),[128] the Unilateral Sale Initiating Member shall give the Unilateral Sale Non-Initiating Member **[ROFO 1**: written notice (a "**First Offer Notice Request**") requesting that, within ___ days[129] after delivery of such First Offer Notice Request (the "**First Offer Period**") the Unilateral Sale Non-Initiating Member provide to the Unilateral Sale Initiating Member**]** a "First Offer Notice" (as defined below).

12.2.2 First Offer Notice. A "**First Offer Notice**" shall be a written notice setting forth an all-cash purchase price[130] (the "**ROFO Property Price**") for the Property.[131] A First Offer Notice shall constitute an offer by the **[ROFO 1**: Unilateral Sale Non-Initiating Member to purchase**] [ROFO 2**: the Unilateral Sale Initiating Member to sell**]** the Membership Interest of the Unilateral Sale Initiating Member as hereinafter provided.

12.2.3 ROFO Election. The Unilateral Sale **[ROFO 1**: Initiating**] [ROFO 2**: Non-Initiating**]** Member shall have ___ days[132] (the "**ROFO Election Period**") after receipt of the First Offer Notice to elect to **[ROFO 1**: sell**] [ROFO 2**: purchase**]** the Membership Interest of the Unilateral Sale Initiating Member. Such election (the "**ROFO Election**") shall be made, if at all, by giving written notice ("**ROFO Election Notice**") thereof to the other Member within the ROFO Election Period.[133]

A. *Election to Proceed with Inter-Member Sale*. If the Unilateral Sale **[ROFO 1**: Initiating**] [ROFO 2**: Non-Initiating**]** Member delivers a ROFO Election Notice within the ROFO Election Period, then the Unilateral Sale Initiating Member shall sell, and the Unilateral Sale Non-Initiating Member shall buy, the Unilateral Sale Initiating Member's Membership Interest, upon and subject to the terms and conditions of Section 13.

B. *Failure to Make Election*. If the Unilateral Sale **[ROFO 1**: Initiating**] [ROFO 2**: Non-Initiating**]** Member fails to deliver the ROFO Election Notice during the ROFO Election Period, **[ROFO 1**: or if the Unilateral Sale Non-Initiating Member fails to give the Unilateral Sale Initiating Member a First Offer Notice during the First Offer Period**]**, then:

(1) the Unilateral Sale Non-Initiating Member shall be deemed to have waived its first offer right (the "**ROFO Waiver**") under this Section 12.2, subject to possible reinstatement under clause B(3) below;

(2) the Unilateral Sale Initiating Member may consummate the proposed sale during the Unilateral Sale Closing Period in accordance with Section 12.1; and

(3) if a sale is not consummated within the Unilateral Sale Closing Period in accordance with Section 12.1 above, then the rights of the Unilateral Sale Non-Initiating Member to notice and first offer as aforesaid will continue as to any other sale of the Property proposed by the Unilateral Sale Initiating Member.

* * *

BUY/SELL

12.3 Buy/Sell.

12.3.1 Buy/Sell Notice. Either Member[134] (the "**Buy/Sell Initiating Member**") may, in its sole and absolute discretion, at any time during the "Buy/Sell Exercise Period" (as hereinafter defined), institute the buy/sell procedure prescribed by this Section by delivering to the other Member (the "**Buy/Sell Non-Initiating Member**") a written notice of its decision to do so ("**Buy/Sell Trigger Notice**"), which notice shall set forth a price for the Property[135] (such amount being herein called the "**Buy/Sell Property Price**").

12.3.2 Buy/Sell Exercise Period. The "**Buy/Sell Exercise Period**" means the period from and after the ___ anniversary of the date of this Agreement.[136]

12.3.3 Buy/Sell Election. If the Buy/Sell Initiating Member gives the Buy/Sell Non-Initiating Member a Buy/Sell Trigger Notice during the Buy/Sell Exercise Period, then the Buy/Sell Non-Initiating Member shall elect either (1) to purchase the Membership Interest of the Buy/Sell Initiating Member, or (2) to sell to the Buy/Sell Initiating Member the Membership Interest of the Buy/Sell Non-Initiating Member, in either case on the terms and conditions set forth in Section 13. Such election shall be made by written notice ("**Buy/Sell Election Notice**") from the Buy/Sell Non-Initiating Member to the Buy/Sell Initiating Member within _____ (___)[137] days (the "**Buy/Sell Election Period**") after the giving of the Buy/Sell Trigger Notice; if the Buy/Sell Non-Initiating Member fails to give such notice within the Buy/Sell Election Period, then it shall be deemed to have given a Buy/Sell Election Notice (on the last day of the Buy/Sell Election Period) electing to sell. The Members shall cause such purchase or sale to occur in accordance with the terms and conditions set forth in Section 13.

* * *

PUT/CALL

12.4 Put/Call. The Members shall have the following put and call options:

12.4.1 Put/Call Notice. Either Member[138] may, in its sole and absolute discretion, at any time during the "Put/Call Exercise Period" (as hereinafter defined), elect to institute the put/call procedure prescribed by this Section by delivering to the other Member a written notice of its decision to do so ("**Put/Call Notice**"), in which event the Members shall proceed to determine the value (the "**Project Value**") of the Property[139] in accordance with Exhibit ___ (the "**Valuation Exhibit**").[140]

12.4.2 Put/Call Election. If a Member gives the other Member a Put/Call Notice within the Put/Call Exercise Period, then the Put/Call Selling Member shall sell, and the Put/Call Purchasing Member shall purchase, the Membership Interest of the Put/Call Selling Member on the terms and conditions set forth in Section 13.

12.4.3 Definitions. The following terms shall have the meanings indicated:

- "**Put/Call Exercise Period**" means the period from and after the _____ anniversary of the date of this Agreement.[141]
- "**Put/Call Purchasing Member**" means _____ [*insert name of member with right to buy*].
- "**Put/Call Selling Member**" means _____ [*insert name of member with right to sell*].

* * *

GENERAL

12.5 Improper Notices.[142] Notwithstanding the foregoing provisions of this Section 12: no Member shall initiate the procedure under Section 12.1, 12.3 or 12.4 during any period (a) after a procedure under Section 12.1, 12.2, 12.3 or 12.4 has been initiated unless and until the previously initiated procedure is terminated or expires or (b) while the Company or any Company Subsidiary is under contract (including a letter of intent) to sell the Property.[143]

* * *

INTER-MEMBER SALE

Section 13. **Inter-Member Sale Under ROFO, Buy/Sell or Put/Call**. The provisions of this Section 13 shall apply to any sale ("**Member Sale**") of the Membership Interest of a Member ("**Selling Member**") to the other Member ("**Purchasing Member**") pursuant to the provisions (the "**ROFO Provisions**") of Section 12.2, the provisions (the "**Buy/Sell Provisions**") of Section 12.3, or the provisions (the "**Put/Call Provisions**") of Section 12.4. The delivery of a "Member Sale Election Notice" (as hereinafter defined) shall create a contract between Selling Member and Purchasing Member for the Member Sale on the terms and conditions hereinafter set forth in this Section 13.

13.1 Certain Definitions. As used herein:

13.1.1 "**Escrow Agent**" means _____.

13.1.2 "**Member Sale Closing**" means the closing of the sale by Selling Member to Purchasing Member pursuant to this Section 13.

13.1.3 "**Member Sale Closing Date**" means the date which is _____ (___) days[144] after the Member Sale Election Notice is delivered (or deemed delivered), or such other date as may be agreed upon in writing by the Members. However, for purposes of the Put/Call, the Member Sale Closing Date shall be __ business days after the Project Value has been determined under the Valuation Exhibit.

13.1.4 "**Member Sale Election Notice**" means (1) the ROFO Election Notice in the case of a Member Sale under the ROFO Provisions, (2) the Buy/Sell Election Notice in the case of a Member Sale under the Buy/Sell Provisions, and (3) the Put/Call Notice in the case of a Member Sale under the Put/Call Provisions (recognizing that the Member Sale Election Notice is the same as the Member Sale Trigger Notice for purposes of the Put/Call Provisions).

13.1.5 "**Member Sale Election Period**" means (1) the ROFO Election Period in the case of a Member Sale under the ROFO Provisions, and (2) the Buy/Sell Election Period in the case of a Member Sale under the Buy/Sell Provisions. There is no Member Sale Election Period in the case of a Member Sale under the Put/Call Provisions.

13.1.6 "**Member Sale Interim Period**" means the period from and including the date of the Member Sale Trigger Notice to and including the Member Sale Closing Date, but not including the portion, if any, of the Member Sale Closing Date after the Member Sale Closing.

13.1.7 "**Member Sale Trigger Notice**" means (1) the First Offer Notice in the case of a Member Sale under the ROFO Provisions, (2) the Buy/Sell Trigger Notice in the case of a Member Sale under the Buy/Sell Provisions, and (3) the Put/Call Notice in the case of a Member Sale under the Put/Call Provisions.

13.1.8 "**Membership Interest**" of a Member means such Member's entire membership interest in the Company, all rights and interests provided hereunder for such Member (subject to the retention of any rights or obligations by a Member following the transfer of its Membership Interest as expressly provided in this Agreement) and all of its right, title and interest in the Company, including (a) its right to receive distributions from the Company, (b) its voting, control and other management rights relating to the Company, the Company Subsidiaries or their respective assets or operations, whether such rights are derived from this Agreement or applicable law, and (c) any right, title or interest in the Company previously held by such Member (on or after the date of this Agreement) that has been sold, assigned or otherwise transferred in violation of this Agreement.

13.1.9 "**Project Price**" means (1) the ROFO Property Price in the case of a Member Sale under the ROFO Provisions, (2) the Buy/Sell Property Price in the case of a Member Sale under the Buy/Sell Provisions, and (3) the Project Value in the case of a Member Sale under the Put/Call Provisions.

13.2 Member Sale Purchase Price. The purchase price of the Membership Interest of Selling Member will be such as will produce for Selling Member the same net amount as Selling Member would have received if the Property had been sold on the Member Sale Closing Date for **[**immediately available federal funds**] [**Note: Modify if assumption of existing loan permitted**]** equal to the Project Price (and the prorations and other adjustments under Section 13.3.2 below had been made, but without deduction for hypothetical closing costs) and the Company had been dissolved and liquidated immediately following such sale and the proceeds of such sale and the other assets of the Company,[145] remaining after satisfaction of (or setting aside reserves for the expected payment of) the actual debts and liabilities (taking into account anticipated discounts and settlements) of the Company (without double-counting in light of the prorations in Section 13.3.2A below), had been distributed to the Members in accordance with the provisions of this Agreement (and any amount payable under Sections ____ ("Clawback") and 13.3.4 ("Satisfaction of Internal Loans") had been paid). If Selling Member would receive nothing in such event and would instead be obligated to pay some amount to the Company or Purchasing Member or both, the purchase price of the Membership Interest of Selling Member shall be deemed to be a negative amount and Selling Member shall be obligated to pay such amount to the Company or Purchasing Member, as applicable.[146] Such purchase price shall be calculated as of the Member Sale Closing Date after making the adjustments under Section 13.3.2 below (such purchase price, as so adjusted, being herein called the "**Member Sale Purchase Price**").

13.2.1 Member Sale Deposit. Within five (5) business days after the delivery of the Member Sale Election Notice (or after the expiration of the Member Sale Election Period if no Member Sale Election Notice is delivered), Purchasing Member shall deposit in escrow with Escrow Agent in an interest-bearing account a deposit by wire transfer of immediately available federal funds in an amount equal to _____ percent (___%) of the Member Sale Purchase Price, as estimated in good faith by the Purchasing Member (together with any interest earned thereon while in escrow, the "**Member Sale Deposit**").[147] Either Member may request the Company accountants to estimate the Member Sale Purchase Price and such deposit amount, and the Members shall adjust the amount of such deposit as necessary to match the revised estimate within five (5) business days after receiving notice of the accountants' determination. The parties shall cause escrow instructions (the "**Member Sale Escrow Instructions**"), in form reasonably satisfactory to the parties (and if agreement is not reached, using Escrow Agent's standard form escrow instructions), to be executed with Escrow Agent to govern such escrow in accordance with the terms of this Section 13.

A. Failure to Pay Deposit. If Purchasing Member fails to deliver the Member Sale Deposit (including any adjustment as determined by the Company accountants) within the required time period, then Selling Member may terminate the Member Sale and subsection C below shall apply (so that, without limitation, Purchasing Member shall pay the Member Sale Deposit to Selling Member as liquidated damages, together with any amount due under Section ___ ("Attorneys' Fees").

B. Selling Member Closing Default. The Member Sale Deposit, if made, shall be non-refundable to Purchasing Member in all events other than the failure of the closing of the sale of Selling Member's Membership Interest to occur by reason of the default by Selling Member (in which event Purchasing Member may terminate the Member Sale and obtain a prompt refund of the Member Sale Deposit).

C. Purchasing Member Closing Default. In the event Purchasing Member breaches its obligation to close the Member Sale, Selling Member may, as its sole and exclusive right to damages for such breach (but without limiting Selling Member's rights under the immediately succeeding sentence and under Section ____ ("Attorneys' Fees")), terminate the Member Sale and receive and retain the Member Sale Deposit

which shall promptly be delivered to Selling Member as liquidated damages. If Selling Member so terminates the Member Sale, then Selling Member shall have the right, but not the obligation (in addition to its retention of the Member Sale Deposit) to acquire the interest of Purchasing Member in accordance with this Section 13 (as though the roles of the Members were reversed) using the same Project Price,[148] but (1) using the closing date specified by Selling Member as hereinafter provided, (2) Selling Member shall not be required to post a deposit in connection with its purchase of Purchasing Member's interest under this subsection C, and (3) to the extent that the Member Sale Deposit has not been delivered to Selling Member by the Member Sale Closing Date, Selling Member may credit the amount of such Member Sale Deposit against the price payable for Purchasing Member's Membership Interest. Such right shall be exercised, if at all, by written notice to Purchasing Member given within thirty (30) days after the original Member Sale Closing Date, which notice shall specify the closing date for Selling Member's purchase, but in no event shall such closing date be later than sixty (60) days after the original Member Sale Closing Date.

D. Application at Closing. Upon the closing of the sale on the Member Sale Closing Date, the Member Sale Deposit shall be a credit against the Member Sale Purchase Price.

13.3 Member Sale Closing. The Member Sale Closing shall occur on the Member Sale Closing Date through the escrow opened with Escrow Agent in accordance with the Member Sale Escrow Instructions.

13.3.1 Closing Deliveries. On the Member Sale Closing Date:

A. Assignment of Selling Member's Interest. Selling Member shall deliver to Escrow Agent (1) a duly executed and acknowledged assignment of the Membership Interest of Selling Member, which assignment shall be sufficient to transfer the same, contain the warranty of Selling Member that Selling Member has (and Purchasing Member shall acquire thereunder) good title to such Membership Interest, free and clear of all liens, encumbrances, claims, rights and options of any kind or character whatsoever (but subject to this Agreement) and otherwise be in form reasonably satisfactory to both Selling Member and Purchasing Member; and (2) a federal certificate of "non-foreign" status (and, if required under applicable state law, its state equivalent) in form reasonably satisfactory to the Members duly executed by Selling Member or, if Selling Member is a "disregarded" entity, then Selling Member's applicable non-disregarded parent entity.

B. Payment of Member Sale Purchase Price. Purchasing Member shall deliver to Escrow Agent, by wire transfer of immediately available federal funds, the Member Sale Purchase Price (less the amount of the Member Sale Deposit then held by Escrow Agent or credited in accordance with Section 13.2.1C above).

C. Further Instruments. Each Member shall deliver such additional documents as may be reasonably required by the other Member in order to consummate the sale (provided the same do not increase in any material respect the costs to, or liability or obligations of, the delivering party in a manner not otherwise provided for herein).

D. Project Financing Guaranties and Bond Indemnities.

(1) *Release or Indemnification of Selling Member*. Purchasing Member shall use good faith efforts to cause the Project Lender and the surety under any bond indemnity or similar undertaking to release Selling Member and its Affiliates from any personal liability under any "**Loan Guaranty**" (i.e., environmental indemnity, guaranty, or similar recourse document) or any bond indemnity or similar undertaking (executed by Selling Member or its Affiliates) accruing after the Member Sale Closing (and if obtained, to deliver such releases to Escrow Agent). If any such release is not obtained on or before the Member Sale Closing Date, then Purchasing Member shall cause a creditworthy Affiliate of Purchasing Member reasonably acceptable to Selling Member to indemnify, defend and hold harmless Selling Member and its Affiliates (under an indemnity in form reasonably satisfactory to the Members, which shall be delivered to Escrow Agent) from and against any such

personal liability to the Project Lender or surety, as applicable, accruing after the Member Sale Closing (unless and until such release is obtained), except to the extent such personal liability is caused by a matter described in the "**Member Indemnity**" (i.e., the indemnification provisions in such Section ___[149]) as to which Selling Member is obligated to indemnify the Company (under such Section).

(2) *Indemnification of Purchasing Member*. If the Project Lender requires that Purchasing Member or one or more of its Affiliates assume any liability of Selling Member or any Affiliate of Selling Member, accruing prior to the Member Sale Closing Date, under any Loan Guaranty executed by Selling Member or such Affiliates, then Selling Member shall cause a creditworthy Affiliate of Selling Member reasonably acceptable to Purchasing Member to indemnify, defend and hold harmless Purchasing Member or such Affiliate or Affiliates of Purchasing Member, or both, as the case may be (under an indemnity in form reasonably satisfactory to the Members, which shall be delivered to Escrow Agent), from and against any such assumed liability to the Project Lender, or any replacement lender thereof, accruing prior to the Member Sale Closing, to the extent Selling Member is responsible therefor under the Member Indemnity.

(3) *Termination of Indemnification*. However, any indemnification provided under this subsection D shall automatically terminate upon receipt of a release of the indemnitee(s), to the extent so released, and (if relating to liability under the Project Financing documents) such release shall be deemed given if the Project Financing is fully repaid or defeased. For the avoidance of doubt, no indemnification relating to the Project Financing shall be required under this subsection D if the Project Financing is fully repaid or defeased at the Member Sale Closing.

13.3.2 Closing Adjustments.[150] At the Member Sale Closing, the following adjustments shall be made in order to complete the final calculation of the Member Sale Purchase Price under Section 13.2.

A. Prorations. The Project Price shall be adjusted by prorations that would be made between a hypothetical seller and a hypothetical buyer of the Property, on and as of the Member Sale Closing Date, of **[****if applicable**: leasing costs****]**, operating expenses and operating income of the Company in accordance with **[****Choose alternative**: the applicable local custom ****OR**** the proration provisions in Exhibit "___" ****OR**** the proration provisions in Section ___ of the Purchase Agreement, *mutatis mutandis****]**. However, no proration adjustment shall be double-counted in the hypothetical liquidation contemplated in Section 13.2 (e.g., if the Project Price is reduced by a proration credit for accrued and unpaid expenses, such expenses will not also be deducted as liabilities in the hypothetical liquidation)**[****if applicable**: ; and no proration for leasing costs shall be double-counted as a capital expenditure under Section 13.3.2C(1) (e.g., if the Project Price is increased by a proration credit for a leasing cost incurred for a new lease, such cost shall not also increase the Project Price under Section 13.3.2C(1) as a capital expenditure)****]**. Unpaid receivables of operating income will not immediately adjust the Project Price or be included in the hypothetical liquidation under Section 13.2, but shall be allocated as and when received (with the understanding that all receipts from any particular payor shall be applied to the most recently accrued receivables from such payor); and the Members shall promptly make such payments as may be required to effectuate the foregoing.

B. Closing Costs. There shall be no adjustment to the Project Price for hypothetical closing costs (e.g., brokerage commissions) of the Company in connection with the hypothetical sale of the Property. Without limitation on the foregoing, no prepayment/defeasance costs shall be deducted (and no prepayment/defeasance lockout shall be deemed to apply) under Section 13.2 above; however, for the avoidance of doubt, any prepayment/defeasance costs actually payable in connection with the Member Sale shall be paid by the Company in accordance with the immediately following sentence and consequently, may reduce the assets that are taken into account in the hypothetical liquidation contemplated by Section 13.2 above. Each of the Members shall bear the actual closing costs incurred by it in connection with the Member Sale under this Section 13, except that

(1) escrow charges shall be shared equally, and (2) the Company shall pay with funds obtained (and set aside) prior to the Member Sale Closing: (x) any prepayment/defeasance or transfer/assumption costs under the Project Financing required to be paid by the Company or a subsidiary or either Member as a result of the Member Sale, and (y) any transfer taxes required to be paid by the Company or a subsidiary or either Member as a result of the Member Sale. If the Company does not have sufficient funds to pay such costs, then the Members shall contribute the deficiency in accordance with Section ___.[151]

C. Interim Event Adjustments.[152] The following adjustments shall be made to the Project Price in order to address certain expansions, improvements and depletions of the Property during the Member Sale Interim Period:

(1) *Capital Expenditures*. There shall be added to the Project Price the sum of all capital expenditures[153] paid or incurred by the Company during the Member Sale Interim Period (other than capital expenditures included in the estimated costs of work or restoration that are deducted in the calculation of net sale proceeds or net property insurance proceeds under subsection (2) or (3) below). For the avoidance of doubt, if such a capital expenditure is incurred but not paid and the Company has a corresponding right to reimbursement or payment for the same (e.g., under insurance), then the outstanding expense for such capital expenditure will be offset by the value of such receivable in the hypothetical liquidation contemplated by Section 13.2 above.

(2) *Dispositions*. To the extent that any portion of the Property has been sold or condemned during the Member Sale Interim Period, the Project Price shall be reduced by the amount of sale or condemnation proceeds (other than the proceeds from a temporary taking, which shall be treated like rent for the period to which they relate), net of closing (and collection) costs and the estimated cost of work required to be done by the seller, received therefrom by the Company (or as to which a Company receivable is created) during the Member Sale Interim Period. However, there shall be no double-counting of such closing (and collection) costs that remain outstanding (x) in the foregoing calculation of "net" proceeds, on the one hand, and (y) in the calculation of net distribution proceeds in the hypothetical liquidation contemplated by Section 13.2 above, on the other hand.

(3) *Damage*. The Project Price shall be reduced by (a) the amount of any property insurance proceeds (excluding rental income proceeds which shall be treated as rent for the period to which they relate), net of collection and estimated restoration costs, received by the Company (or as to which a Company receivable is created) for damage to the Property occurring during the Member Sale Interim Period and (b) the amount of the applicable deductible with respect to such damage under any insurance carried by the Company covering such damage (not greater than the estimated restoration costs). However, there shall be no double-counting of such closing, collection and restoration costs that are deducted, and the restoration and other costs attributable to such deductible, in each case that remain outstanding, (x) in calculating the amount of such reduction, on the one hand, and (y) in the calculation of net distribution proceeds in the hypothetical liquidation contemplated by Section 13.2 above, on the other hand.

13.3.3 Process. All adjustments to the Project Price pursuant to Section 13.3.2 shall be made on the basis of good faith estimates of the Members using currently available information, and final adjustment shall be made by the Members promptly after precise figures are determined or available, and in any event within _____ (___) days after the Member Sale Closing Date. Unless the Members otherwise agree in writing, the Members shall engage the Company accountants to calculate the Membership Interest Purchase Price and shall use reasonable efforts to maintain the confidentiality of any confidential information provided to the Company accountants. If either Member disputes the results of such calculation (provided that no Member may dispute the pre-adjustment Project Price), then at the election of either Member, to be exercised by written notice (the "**Estimated Price Closing Election**") to the other Member prior to the Member Sale Closing, the Members shall proceed with Member Sale Closing using the calculation of the Company accountants (or if there is no such calculation, either Member may agree to proceed using the calculation of the other Member) but reserving their rights to dispute the amount of the Membership Interest Purchase Price after the Member Sale Closing; and if it is

ultimately determined by a court of competent jurisdiction that the amount used for the Membership Interest Purchase Price was incorrect, then the Members shall promptly make such adjustments (and payments to one another) including adjustments to the amounts payable under Section 13.3.5 below, as may be required to reflect the correct amount of the Member Sale Price.

13.3.4 Satisfaction of Internal Loans. On the Member Sale Closing Date (immediately prior to the Member Sale Closing), Internal Loans shall be paid in full to the extent not effectively repaid by reason of the calculation (including the hypothetical sale, liquidation and distribution) in Section 13.2 and payment of the Member Sale Purchase Price on the Member Sale Closing Date. If the Company does not have sufficient funds to make any such required payment payable by the Company, then the Members shall contribute the deficiency in accordance with Section ___. "**Internal Loans**" means any loans pursuant to this Agreement between a Member (whether as borrower or lender), on the one hand, and the other Member or the Company, on the other hand.

13.3.5 Distributable Cash. The Members shall be distributed their share of Distributable Cash up to the Member Sale Closing Date (immediately prior to the calculation of the Member Sale Purchase Price under Section 13.2), with final adjustment thereafter if final figures of Distributable Cash are not available.

13.4 Assignment. Provided all required consents under all Business Agreements (including the Project Financing Documents) have been obtained, Purchasing Member may, at any time prior to such escrow closing, assign to any person or entity its right to receive the assignment under this Section 13 of Selling Member's Membership Interest, but such assignment shall not relieve Purchasing Member of its obligations and liabilities hereunder. However, no such assignment shall be permitted unless Purchasing Member executes and delivers to Selling Member, at least two (2) business days prior to the Member Sale Closing Date, an assignment and assumption agreement in form reasonably satisfactory to the Members, which shall include, among other matters, a representation from the assignee to Selling Member that the matters set forth in Section ___ ("Sophisticated Investor") of this Agreement are true and correct with respect to such assignee.

13.5 Contingencies; Representations. The sale shall be on an as-is basis without any contingencies, representations or warranties, except for the title warranty required under Section 13.3.1A.[154]

13.6 Future Liability. Selling Member shall have no liability for any obligations accruing under this Agreement after the Member Sale Closing except (1) under the Member Indemnity for the acts or omissions of Selling Member and its Affiliates prior to the Member Sale Closing or (2) as expressly provided in this Section 13 or the documents executed under this Section 13. The "**Company Indemnity**" (i.e., the indemnification provisions in Section ___[155]) shall continue to benefit Selling Member after the Member Sale Closing.

13.7 Remedies. Except as expressly set forth in this Section 13: the remedies set forth herein for a breach of this Section 13 are not exclusive and, without limitation on the foregoing, each of the Members shall have the right to specifically enforce the provisions of this Section 13.

13.8 Tax Considerations. Each Member shall cooperate with any reasonable request made by the other Member to implement the sale contemplated by this Section 13.8 in a tax-efficient manner. However, this Section 13.8 shall not obligate a Member to incur any increased cost, liability or risk without indemnification in form, and from an indemnitor, acceptable to such Member.

* * *

OPTIONAL PROVISIONS

1. **Price vs. Value**. As discussed in Section 5.3 in the body of this Article, the members may wish to have explicit provisions in § 12.2.2 of the ROFO or § 12.3.1 of the Buy/Sell regarding the relationship between the designated price and the fair market value of the Property. If so, consider adding provisions along the following lines:

(a) If the Members are concerned about second-guessing:

> The [ROFO/Buy/Sell] Property Price need not have any relationship to fair market value and may be determined in the sole and absolute discretion of such Member.

(b) If the Members are concerned about manipulation:

> The [ROFO/Buy/Sell] Property Price shall be such Member's good faith estimate of the fair market value of the Property.

2. **Express Disclosure Obligations**. As discussed in Section 5.6.4 in the body of this Article, the members may be worried about informational disadvantages with respect to the venture's sales activity. If so, consider adding something along the following lines:

> Prior to _____, each Member shall disclose in writing to the other Member a description of any negotiations or discussions with third parties such Member may have had regarding the sale of its interest in the Company or the Property or any portion thereof.

3. **Unilateral Sales to Affiliates**. As discussed in Section 6.3 in the body of this Article, the members may be concerned about discussions with potential buyers deflating the price. If so, consider adding the following provisions to Section 12.1.3:

> Without limitation on the foregoing, each Member shall not, and shall not permit any Affiliate (or any entity in which an Affiliate is known by such Member to have direct or indirect interest, whether equity or debt, other than through the ownership of publicly traded shares of stock or its interest in the Company) to, bid on, purchase or otherwise become (or seek to become), an owner of an interest in the Property or the profits or proceeds therefrom (whether through equity, debt, or profit participation) or a provider of closing or post-closing services relating to the Property in connection with a sale by the Company or a Company Subsidiary.

4. **Relief From ROFO Minimum Price Requirement**. Section 6.4 in the body of this Article discusses possible exceptions to the minimum third-party price requirement in the ROFO (beyond the margin of error). If any such exceptions are desired, consider adding ", subject to the following:" to the end of Section 12.1.4 and then adding the exceptions.

4.1 *Expedited Restart of ROFO Process*. The members may allow an expedited restart of the ROFO process, as discussed in Section 6.4.2 in the body of this Article. Here are sample provisions:

> 12.2.4 Notwithstanding the provisions of Section 12.5, the process under this Section 12.2 may be restarted by the Unilateral Sale Initiating Member on an expedited basis, so that **[<u>ROFO 1</u>**: the First Offer Period for such restarted process shall be reduced to __ days and**]** the ROFO Election Period for such restarted process shall be reduced to ___ days, but only if each of the following conditions is satisfied: (a) **[<u>ROFO 1</u>**: the Unilateral Sale Non-Initiating Member**] [<u>ROFO 2</u>**: the Unilateral Sale Initiating Member**]** has provided a First Offer Notice (the "**Prior First Offer Notice**") that is not accepted by the other Member during the ROFO Election Period, and (b) within ____ days after the expiration of the ROFO Election Period for the Prior First Offer Notice, the Unilateral Sale Initiating Member sends to the Unilateral Sale Non-Initiating Member another First Offer Notice **[<u>ROFO 1</u>**: Request**]**.

4.2 *Making the Non-Initiating Member Whole*. The members may be willing to let the initiating member go through with the sale *at any lower price* as long as the non-initiating member receives no less than what it would have received had the minimum price been paid, as discussed in Section 6.4.3 in the body of this Article. Here are sample provisions:

> The Unilateral Sale Initiating Member may elect to cause the Property to be sold for less than the Minimum Required Sale Price by sending written notice ("**Shortfall Election Notice**") of such election to the Unilateral Sale Non-Initiating Member prior to the execution of any binding agreement or commitment to sell at a price less than the Minimum Required Price. If a Shortfall Election Notice is given, then at the closing of such sale, the Unilateral Sale Initiating Member shall pay to the Unilateral Sale Non-Initiating Member the "**Shortfall**" (i.e., the amount by which (1) the proceeds from such sale that the Unilateral Sale Non-Initiating Member would receive (in the absence of this Section ___) if the price equaled such lower price is less than (2) the proceeds from such sale that the Unilateral Sale Non-Initiating Member would receive if the price equaled the Minimum Required Sale Price). The Unilateral Sale Initiating Member shall not be entitled to any contribution, capital account or other credit for its payment of the Shortfall. If the Unilateral Sale Initiating Member has given a Shortfall Election Notice, then all proceeds from such sale that would otherwise be distributed or paid to the Unilateral Sale Initiating Member (but for this paragraph), up to the amount of the Shortfall, shall be paid instead to the Unilateral Sale Non-Initiating Member (such diverted proceeds being herein called the "**Diverted Proceeds**"). The Diverted Proceeds shall be deemed to have been received by the Unilateral Sale Initiating Member and then paid over to the Unilateral Sale Non-Initiating Member. If the Diverted Proceeds are less than the Shortfall (the difference being herein called the "**Deficiency**"), then the Unilateral Sale Initiating Member shall pay, from its own funds, the Deficiency to the Unilateral Sale Non-Initiating Member. If the Unilateral Sale Non-Initiating Member believes in good faith that there will be a Deficiency, then by giving written notice thereof to the Unilateral Sale Initiating Member within ___ days of its receipt of the Shortfall Election Notice, it may require, as a condition to the Unilateral Sale Initiating Member's right to enter into any agreement or other commitment to sell the Property for a price less than the Minimum Required Sale Price, that the Unilateral Sale Initiating Member deposit in escrow with Escrow Agent the Unilateral Sale Non-Initiating Member's good faith estimate of the Deficiency, but not more than the amount by which such price is less than the Minimum Required Sale Price. Such escrow shall be

> governed by escrow instructions reasonably satisfactory to both Members (and if agreement is not reached, using Escrow Agent's standard form escrow instructions), which shall provide that (x) the Unilateral Sale Initiating Member may require Escrow Agent to disburse amounts from such escrow to the other Member to make the payments under the foregoing provisions and (y) no amounts in such escrow will be disbursed to either Member until both Members give joint written instructions to do so.

5. **Allowing Loan Assumption in Unilateral Sale**. The possibility that the Unilateral Sale Right may involve a loan assumption is discussed in Section 6.2 in the body of this Article.

5.1 *Right to Sell Subject to the Loan*. If the initiating member has discretion to sell for cash or subject to debt or both, then Section 12.1 should be modified. For example, one might say:

> (a) The Purchase Price for the Property shall be payable (i) in cash, (ii) by assuming the Project Financing, or (iii) both, subject to the requirements of the Project Financing Documents.

5.2 *Loan Guaranties*. If there are loan guaranties, the members might want to address them in a manner similar to what is done for an inter-member sale:

> If the Project Financing is to be assumed, then the provisions of Section 13.3.1D shall be incorporated, *mutatis mutandis*, into the purchase and sale agreement (and for this purpose, but without limitation on the foregoing, (x) all references in Section 13.3.1D to Selling Member shall mean each Member who (or whose Affiliate) has provided a Loan Guaranty or a bond indemnity, (y) all references in Section 13.3.1D to Purchasing Member shall mean the third-party buyer, and (z) it will be a condition to closing that the third-party buyer performs its obligations under such incorporated provisions).

In a loan assumption, the existing guarantors typically sign one or more loan assumption documents so the statement in Section 12.1.6 may require some qualification.

5.3 *Compliance with the Loan Documents*. The following provision may be added to confirm that any loan payoff or loan assumption must comply with the loan documents:

> If the Project Financing Documents prohibit the prepayment or defeasance of the loan evidenced and secured thereby on the closing date, then none of the Unilateral Sale Initiating Member, the Company or any Company Subsidiary may close the sale of the Property (or any portion thereof), unless such loan is assumed by the buyer in accordance with the Project Financing Documents or the Project Lender approves the prepayment or defeasance of such loan (notwithstanding such prohibition in the Project Financing Documents).

5.4 *Addressing Possible Loan Assumption*. If the members want to include provisions that will apply if, and only if, a loan assumption is approved as a major decision, then something along the following lines may be added to Section 12.1.5:

> The provisions hereinafter set forth in this subsection 12.1 that address the possibility that there is an assumption of the Project Financing are not intended to (and shall not) limit the

> requirements of this clause 12.1.5.

6. **Restricting the Use of the ROFO Margin of Error**. As discussed in Section 6.2.1 in the body of this Article, it is possible to limit the right to use the margin of error prior to or at the time of the execution of a purchase agreement. Here are sample provisions (that could replace Section 12.1.4):

> If there is a First Offer Notice, then any such sale must be for a purchase price not less than [100%/99%] of the ROFO Property Price (provided that the sale of the Property may be effected at a price not less than ___ [insert lower % than prior %] of the ROFO Property Price so long as any reduction below [100%/99%] of the ROFO Property Price occurs as a result of a good faith adjustment after a bona fide purchase agreement has been entered into at not less than [100%/99%] of the ROFO Property Price).

7. **Authority to Sell the Property**. The initiating member may want the non-initiating member to have an affirmative obligation to confirm in writing the initiating member's authority and the waiver of the ROFO for the sale in question. Here is sample language:

> The Unilateral Sale Non-Initiating Member shall promptly, and in any event, within five (5) days after request therefor from the Unilateral Sale Initiating Member, execute such documentation as the Unilateral Sale Initiating Member shall reasonably request evidencing such Unilateral Sale Initiating Member's right to market and sell the Property (and execute documents) on behalf of the Company in accordance with this Agreement. Without limitation on the foregoing, if a ROFO Election is not timely made, then within three (3) business days after the expiration of the "ROFO Election Period" (as hereinafter defined), the Unilateral Sale Non-Initiating Member shall execute and deliver to the Unilateral Sale Initiating Member, written notice (in form reasonably satisfactory to the Unilateral Sale Initiating Member) confirming the "ROFO Waiver" (as hereinafter defined). Such documentation and notice shall not be required to establish the Unilateral Sale Initiating Member's unilateral authority to sell the Property free of the Right of First Offer, but failure to timely deliver any such documentation or notice within the time periods specified shall be a material default under this Agreement.

8. **Improper Notices – Abuse of Process**. What if a member wanted to abuse the sale process by using it to prevent the other member from triggering its exit rights for some period of time? Indeed, if the second variant of the ROFO is adopted (where the initiating member must name a price for the Property), what is to stop a member from triggering the Unilateral Sale at a ridiculously high price with no intention of selling the Property? The provisions of Section 12.5 would appear to preclude the other member from triggering any exit strategy until the sale process is concluded or terminated. In theory, a member could repeat this process indefinitely in an attempt to avoid a Unilateral Sale, Buy/Sell or Put/Call. Could this really work? The author doubts it. Even if the Unilateral Sale provides that the ROFO Property Price need not have any relationship to the fair market value of the Property, the purpose of such freedom (to name any price) is to facilitate a sale without second-guessing. In other words, the provisions are intended to facilitate, rather than obstruct, a sale of the Property. Thus, it would arguably be a breach of the implied covenant of good faith and fair dealing if a member gave a notice under Section 12.1 with no intention of selling. The following language could be added to Section 12.5, but the author questions its value because it could be used for the opposite purpose, namely to question a legitimate exercise of the Unilateral Sale right.

> No Member may give a notice under Section 12.1 unless it has a good faith intention to sell the Property.

Some practitioners try to limit the right of a member to start the sale process after it has initiated the sale process and failed to sell (e.g., by precluding that member from starting the sale for some fixed period of time after the failed sale process or until the other member has triggered the sale process and failed). While these approaches may create an appropriate lockout for a nefarious member, is it possible that they might also prejudice a member who wants to exit but has overpriced the property in good faith? If so, it might make sense to pair such a lockout with the right to reduce the price discussed in paragraph 4 above. Yet another possible approach would be to provide that any second attempt by a member to start the sale process may be nullified by the other member starting the sale process using a lower price (within a certain period of time).

9. **Purchase of Property**. The members might want the option under certain circumstances to have the purchasing member buy the Property rather than the selling member's membership interest. Such a purchase might avoid certain problems associated with contingent assets and liabilities, and more generally, provide more certainty to the exit (in terms of execution and enforcement). For further discussion and sample provisions, see the Hypothetical JV Sale Article.[156]

* * *

APPENDIX B

ACCOMMODATING TAX-FREE EXCHANGE REQUESTS

As indicated in Section 5.11 of the body of this Article, sometimes a member (the "**exchanging member**") may want the right to structure a tax-deferred exchange applicable to its share of sale proceeds from a sale of the Property or for a sale of its interest, or for a purchase of the other Member's interest. This Appendix will address this subject.

STRUCTURING A SALE AS A TAX-FREE EXCHANGE

The exchanging member may not want to be on the *sale* side of a Property or membership interest sale unless it can defer the gain through a tax-free exchange. For example, this situation might arise when the exchanging member has a low tax basis because it contributed the Property to the venture at a value that was higher than the exchanging member's basis at the time. If so, the exchanging member may suggest a so-called "drop and swap" transaction, under which it is first distributed an undivided interest in the Property,[157] and then (1) in the case of a sale of the Property (by the venture to a third party), the venture's buyer would receive two deeds, one from the venture and one from the exchanging member, and (2) in the case of a sale of the exchanging member's interest to the other Member, the other Member would receive a deed instead of an assignment of membership interest.[158] Other restructuring approaches may be suggested, but the drop and swap is the one usually encountered in practice by the author, and will be assumed to be the request made for purposes of this Appendix.[159]

Property Sale. A drop and swap in connection with a venture sale of the Property raises a number of issues:

- *Transfer Taxes*. Will the drop result in additional transfer taxes? (Although the exchanging member typically agrees to pay additional costs, it will want to consider whether the costs are worth the tax benefit.)

- *Loan Document Restrictions*. Will the drop violate the loan documents? Will a loan default pose a problem if (x) the Property is being sold subject to the loan, or (y) the drop occurs before the closing of the third-party sale?

- *Who Is Really Selling?* If the drop occurs *after* the venture has entered into a purchase agreement or a listing agreement, will the exchanging member be acquiring its undivided interest with an intent to transfer rather than to hold "for investment"?[160] Will the transaction be viewed, through a substance over form, or a step-transaction, analysis, as a transfer by the partnership?[161]

- *TIC vs. Disguised Partnership*. If the drop occurs *beforehand*, will the tenancy in common be viewed as a disguised partnership so that a partnership interest is being exchanged (which will not qualify for tax-free treatment)?[162]

- *Simultaneous Transactions*. If the drop occurs simultaneously with the closing, will the "held . . . for investment" requirement be met?[163]

Even with expert tax-planning, the drop and swap is not without tax risk. As noted by one author:

> Unfortunately, there is no recent, clear guidance that specifically states that a "drop and swap" transaction would be allowable under Section 1031.[164]

Conservative tax advisors may suggest (and have suggested in the author's experience) that the Property be held as tenants in common for a substantial period (e.g., 12 months) prior to the exchange,[165] but this may not be practical. Indeed, if there is any meaningful period prior to closing during which the Property is held as tenants in common, then it may be difficult to replicate the rights and protections in the venture agreement without exacerbating the risk that the tenancy in common will be treated as a disguised partnership. For example, how would the undivided interests be determined in advance if they are to be based on the relative proportions of sale distributions (given that most tiered waterfalls with promote structures would yield different proportions for different prices or different times)? Even if the tenancy in common is created only a short period of time before the closing, the other member may be concerned that its ability to effectuate a unilateral sale may be hampered: it will no longer have the same level of control and authority over the exchanging member's TIC interest (as it may have had over the venture's property) because it will not be a direct or indirect owner; and the exchanging member (or its qualified intermediary) would need to sign documents. The third-party buyer's cooperation is also necessary and it may not be excited about signing a contract with, and accepting conveyancing instruments from, multiple parties without, for example, joint and several liability. Unless the distribution of an undivided interest to the exchanging member is simultaneous, it may be difficult to accommodate a request for 1031 accommodation when the Property is sold.

Membership Interest Sale. Many, if not most, of the same issues discussed above may arise when the exchanging member is selling its membership interest to the other member. But in this circumstance, the non-exchanging member would be receiving a deed under the "drop and swap." Some members may not be willing to take title to any portion of the Property, which would rule out an exchange in connection with the sale of the exchanging member's interest to the other member.

STRUCTURING A PURCHASE AS A TAX-FREE EXCHANGE

What if the exchanging member doesn't want to be on the *purchase* side of a membership interest sale unless it can acquire the interest through a tax-free exchange of other real estate it owns? For example, it may be land rich and cash poor and, due to its illiquidity, it needs to tap other real estate assets to pay for the purchase. It may be easier to accommodate this request (i.e., to structure a purchase, rather than a sale, by the exchanging member as an exchange) assuming the exchanging member is willing to forgo a deed and accept an assignment of the other member's interest rather than a deed. A purchase of the other member's interest by the exchanging member would result in a single member LLC, which is a disregarded entity for federal income tax purposes.[166] On this basis, the exchanging member's acquisition of the other member's interest should be viewed for tax purposes as an acquisition of the portion of the Property attributable to that interest.[167] As explained by one expert:

> One exception from the general rule that interests in a partnership are excluded property for purposes of IRC §1031 involves the acquisition of all interests in a partnership not already owned by the taxpayer. . . . Because these acquisitions are regarded as asset purchases, not purchases of partnership interests, it makes sense to treat them as outside the exclusion established by IRC §1031(a)(2)(D) with respect to replacement property acquisition. This conclusion has been confirmed by the IRS in two letter rulings dealing with both deferred and reverse exchanges and with purchase of (1) all interests in a partnership and (2) all interests in a partnership owned by parties other than the taxpayer, when the taxpayer was already a 50 percent partner.[168]

In such circumstances, the purchasing member would want the right to assign to a qualified intermediary its right to acquire the selling member's membership interest so that it could effectuate the exchange as follows:

- the purchasing member would transfer other real estate (the relinquished property) it owns and direct proceeds from the transfer to a qualified intermediary;

- the intermediary would use the proceeds to pay for the selling membership interest; and
- the selling member's interest would be conveyed to the purchasing member.

If the relinquished property is owned by an affiliate of the purchasing member, then the purchasing member will want to assign its membership interest to such affiliate before the exchange so that the owner of the relinquished property already owns all the membership interests that are not being sold. If the selling member is willing to accommodate this request, it will likely request confirmation that it will not be required to incur any cost or liability in connection with the exchange. Also, in a transaction structured as a membership interest acquisition as described above, it will be important to strip all non-real estate assets out of the venture prior to the membership interest transfer. Otherwise, the deemed acquisition of a pro rata interest in those assets could give rise to boot treatment in the purchasing member's exchange.

* * *

[1] Sometimes the parties may use a limited partnership (rather than an LLC) for state or federal income tax reasons. For example, if the institutional investor is (or is owned by) a non-U.S. investor, it may want the JV vehicle to be organized as a limited partnership so that treaty benefits can, as a general matter, flow through the entity. Such a foreign investor may also insist that (i) the JV own its U.S. real estate investments through a subsidiary real estate investment trust (a "**REIT**") in order that effectively connected income ("**ECI**") concerns can be managed; and (ii) the REIT qualify as domestically controlled (or non-controlled by foreign government investors), and any exits from such investments or the JV be structured as sales of equity in the REIT to allow the foreign investor to avoid U.S. taxation under the Foreign Investment in Real Property Tax Act of 1980 ("**FIRPTA**"). Such REIT transactions involve an array of tax concerns (especially for investors who are entitled to the benefits of Section 892 of the Code and Section 897(l) of the Code) that are beyond the scope of this Article. Note that the prospect of acquiring majority ownership of the JV under a right of first offer, buy/sell or put/call may be problematic for foreign investors who need to utilize a domestically controlled REIT. *See, e.g.*, Weiner & Klein, *Foreign Investment in U.S. Real Estate – Now More Than Ever*, 33 PRAC. REAL EST. LAW. 40 (Jan. 2017); Grumbacher, Towsner, Schneider & Norman, *A Primer on Using Private Domestically Controlled REITs for International Investors in U.S. Real Estate*, BLOOMBERG BNA TAX MGMT. REAL EST. J. (Nov. 6, 2013).

[2] Often only one member has a Unilateral Sale Right and the other member may or may not have a ROFO. And even when each member has a unilateral sale right subject to a ROFO, the terms of the unilateral sale or ROFO may be different depending on the member that holds the right.

[3] In some LLC agreements, the price is for "all the assets" of the LLC (rather than only the Property), as noted in Section 5.3 ("What Is Being Priced or Valued?"). For a discussion of the all-asset approach, *see* Hypothetical JV Sale Article, *infra* note 7, § 2, at 8–10.

[4] *Ibid*.

[5] *Ibid*.

[6] Sometimes there is only a Put or only a Call, but we have assumed that both are present. Under the Put/Call (unlike the Buy/Sell), it is known in advance which member will be the seller and which member will be the buyer. It is also possible (and not uncommon) for a Put or a Call or a Put/Call to use pricing that is not based on a hypothetical sale of the Property by the LLC, but such arrangements are not discussed in this Article.

[7] Carey & Nichols, *Hypothetical JV Sales to Value JV Interests in ROFOs, Buy/Sells, Puts, and Calls*, 31 REAL EST. FIN. J. 5 (Spring/Summer 2016).

[8] *See, e.g.*, DOLAN, CAMPBELL & FRANKLIN, BUYING U.S. REAL ESTATE, Insight 14 (Wiley 2012).

[9] *See, e.g.*, Nichols, *Texas Draws and Self-Inflicted Wounds: Exit Strategies Gone Awry*, 5 COM. INVESTMENT REAL EST. J. 6 (Summer 1986); Surkin, *How Do I Get Out of Here? Exit Strategies in Closely-Held Real Estate LLCs*, 18 PRAC. REAL EST. LAW. 27 (May 2002); Ramsey, *Designing Joint Venture Exit Strategies (with Form)*, 18 PRAC. REAL EST. LAW. 35 (Sept. 2002); Berg & Fisch, *Options Vary on Exiting Joint Ventures*, 227 N.Y. L.J. 2 (Jan. 14, 2002); Waters, "Exit Provisions," Part III of Harding, et al., *The Changing World of Real Estate Equity Investment*, ACREL PAPERS, Tab 4, 45 (Part III, 76) (Spring 2008); Katz, *Exiting the Real Estate Joint Venture*, ACREL PAPERS, Tab 7, 157 (Fall 2011). This interpretation of "exit strategy" is not universal. Numerous tax articles refer to a member's "exit strategy" as its strategy to exit from the venture *and* its investment. *See, e.g.*, Infanti, *Structuring Inbound Investments: A Primer on Exit Issues*, 79 TAXES 2 (Feb. 2001) (referring to exit strategies of a foreign partner as "strategies for 'exiting' the proposed inbound investment"); Rubin & Cejudo, *Getting Out of the Deal: Creative Exit Strategies*, 59 N.Y.U. ANN. INST. ON FED. TAX'N § 13.01 (2001) (where the focus is solely on "a partner's departure from the venture"); Foot, *Partnerships: Withdrawals, Distributions, and Other Exit Strategies (Part 1)*, 12 PRAC. TAX LAW. (ALI-ABA Winter 1998).

[10] Levy & Barton, *Avoiding Deadlock in Multi-Party Entities Owning Real Estate*, 19 REAL EST. FIN. J. 5 (Summer 2003).

[11] *See, e.g.*, 1 RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES § 11:2, at 747–48 (Thomson Reuters 2d ed. 2016) ("LLC statutes vary on members' power to voluntarily withdraw and, if they have the power to withdraw, the ability of the members to receive the value of their interests." [footnote omitted]); 1 BISHOP & KLEINBERGER, LIMITED LIABILITY COMPANIES: TAX AND BUSINESS LAW ¶ 8.05[3][c], at 8-90 (WG&L 2011) ("Some LLC statutes provide, in the default mode, for the buyout of members who voluntarily dissociate.").

[12] 6 Del. C. §§ 18-603 (prior to 1996 amendments), 18-604. *See, e.g.*, CAREY & HABBART, DELAWARE LIMITED LIABILITY COMPANY: FORMS AND PRACTICE MANUAL § 8.9.1, at n.20 (DTP 2013).

[13] 6 Del. C. § 18-603.

[14] 6 Del. C. § 18-604; *see also* Del. RULPA § 17-604; Showell v. Pusey, C.A. No. 3970-VCG, 2011 Del. Ch. LEXIS 123, at 16 (Del. Ch. Sept. 1, 2011) ("The statute itself provides that 'fair value' is the measure of the LLC's obligation to a withdrawing

member *only* if the Agreement fails to provide otherwise."); Olson v. Halvorsen, 986 A.2d 1150, 1153, 1157 and 1163 (Del. 2009) (agreement providing "that a departing member will receive only his capital account balance and accrued compensation" trumped any right to fair value under the statute).

15 BISHOP & KLEINBERGER, *supra* note 11, ¶ 9.02[7][a], at 9-41 ("LLC statutes typically permit any member to apply to a court for an order dissolving the LLC." [footnote omitted]); *see also* RIBSTEIN & KEATINGE, *supra* note 11, § 11:5, at 771 ("LLC statutes generally allow dissolution by judicial decree.").

16 6 Del. C. § 18-802.

17 *See, e.g.*, ULLCA § 701(a)(4)(B) (2006) ("(a) A limited liability company is dissolved . . . upon . . . (4) on application by a member, the entry . . . of an order dissolving the company on the grounds that: . . . (B) it is not reasonably practicable to carry on the company's activities and affairs in conformity with the certificate of organization and the operating agreement"); ULPA § 802 (2001) ("On application by a partner the . . . court may order dissolution of a limited partnership if it is not reasonably practicable to carry on the activities of the limited partnership in conformity with the partnership agreement."); BISHOP & KLEINBERGER, *supra* note 11, ¶ 9.02[7][a][i], at 9-41 ("Many LLC statutes . . . authorize court-ordered dissolution only 'if it is not reasonably practicable to carry on the business in conformity with the articles of organization and any operating agreement.'" [footnote omitted]); RIBSTEIN & KEATINGE, *supra* note 11, § 11:5, at 772 ("Some [LLC statutes] allow judicial dissolution when it is 'not reasonably practicable to carry on the business in conformity with the parties' agreement.'" [footnote omitted]); *see also* Del. RULPA § 17-802.

18 BISHOP & KLEINBERGER, *supra* note 11, ¶ 9.02[7][a][i], at 9-42 [footnotes omitted].

19 BISHOP & KLEINBERGER, *supra* note 11, ¶ 9.02[7][a][1], at S9-11.

20 *In re* Arrow Investment Advisors, LLC, C.A. No. 4091-VSC, 2009 Del. Ch. LEXIS 66, at 9 (Del. Ch. Apr. 23, 2009); *see also* Haley v. Talcott, 864 A.2d 86 (Del. Ch. 2004) (judicial dissolution granted where one of two members in a real estate venture sought judicial dissolution because they couldn't agree on whether to sell the venture's real estate; and the court found, among other matters, that the contractual exit provisions were not a fair and reasonable alternative because they did not adequately address the continuing liability of the petitioning member under a personal guaranty); Fisk Ventures, LLC v. Segal, 2009 Del. Ch. LEXIS 7 (Del. Ch. Jan. 13, 2009), *aff'd*, 984 A.2d 124 (Del. 2009) (judicial dissolution granted due to a deadlock despite the availability of a put right because "it would be inequitable for this Court to force a party to exercise its option when that party deems it in its best interests not to do so."); Achaian, Inc. v. Leemon Family LLC, 25 A.3d 800, 812–13 (2011) (to support its judicial dissolution application, member "pled facts sufficient to give rise to the inference that the management of [the venture] [was] deadlocked" and there was no reasonable exit mechanism or other provision to break the deadlock).

21 *See, e.g.*, Haley v. Talcott, *supra* note 20, at 20 ("[T]he remedy of dissolution . . . remains discretionary." [footnote omitted]); Estate of Eric Burke v. Eric S. Burke Home Improvement, C.A. No. 3322-CC, 2009 Del. Ch. LEXIS 253 (Del. Ch. Apr. 14, 2009) (Chancery Court denied summary judgment as to judicial dissolution due to disputed facts regarding a purported deadlock saying "[d]issolution . . . proceedings in deadlocked LLC cases are usually a no win proposition for the LLC members.").

22 *See, e.g.*, R&R Capital, LLC v. Buck & Doe Run Valley Farms, LLC, C.A. No. 3803-CC, 2008 Del. Ch. LEXIS 115 (Del. Ch. Aug. 19, 2008) ("Because the waiver of a member's right to petition for dissolution . . . does not violate the LLC Act and does not interfere with the rights of third parties, a waiver is valid and enforceable under the statute."); Huatuco v. Satellite Healthcare, 2013 Del. Ch. LEXIS 298 (Del. Ch. Dec. 9, 2013), *aff'd*, 93 A.3d 654 (Del. 2014) (judicial dissolution was waived by (1) a provision stating that "*[e]xcept as otherwise required by applicable law, the Members shall only have the power to exercise any and all rights expressly granted to the Members pursuant to the terms of this Agreement*" and (2) a provision allowing for dissolution only upon a super-majority vote). Query whether the *Huatuco* court would have reached the same conclusion in the absence of the general provision limiting rights to those set forth in the agreement?

23 *In re* Carlisle Etcetera LLC, 114 A.3d 592 (Del. Ch. 2015) ("This court has held that the parties to an LLC agreement can waive by contract the right to seek statutory dissolution under *Section 18-802*. [citations omitted] In my view, the ability to waive dissolution under *Section 18-802* does not extend to a party's standing to seek dissolution in equity.").

24 *See, e.g.*, RIBSTEIN & KEATINGE, *supra* note 11, § 11:2, at 753.

25 Some members may prefer to sell 100% of the ownership interests in the venture rather than the real estate because of concerns relating to (1) third-party consents, (2) closing costs, or (3) state or local income taxes. *See, e.g.*, Hypothetical JV Sale Article, *supra* note 7, at ns.16, 17, 18, 19 & 20. (There may also be federal income tax concerns for foreign investors. *See supra* note 1.) One author makes a similar point: "In some localities, sales of venture interests, as compared to a sale of the real estate, will avoid significant conveyance taxes (or deed stamps) and will reduce the likelihood of a real estate tax assessment increase based on a recorded transaction." Surkin, *supra* note 9, at 33. But a growing number of localities with high transfer taxes seem to have adopted controlling interest statutes. *See* cites in Hypothetical JV Sale Article, *supra* note 7, at n.48 for state-by-state surveys of controlling interest transfer tax statutes. And as local governments continue to search for dollars to meet their budgets, it may be

less likely that a controlling interest transfer stays under the radar for purposes of reassessment. But if there is an overall advantage to selling ownership interests rather than real estate, then a member may want a right to sell its interest with a drag-along or simply a right to cause a sale of 100% of the ownership interests rather than the Property. (For example, a foreign investor might want to sell 100% of their REIT shares in a REIT, which is domestically controlled (or non-controlled by foreign government investors), and drag along the other REIT owners and, if the REIT is part of a JV with additional parties, drag along those additional parties too, so that the buyer acquires 100% indirect ownership of the underlying real estate.) If so, note that (a) a promote could make the drag-along difficult, but this could be solved by using a Property value, (b) joint and several liability could be an issue, but could be solved by introducing an intermediate entity (e.g., a disregarded partnership entity in the case of foreign investors) to function as the seller, (c) one needs to be careful about reserving proprietary and confidential assets (and distributing them to the selling members before the sale), including professional relationships of the JV which could otherwise stay with the enterprise, and (d) the buyer will likely want non-imputation protection, so plan to negotiate in advance with the title insurance company for an acceptable non-imputation indemnity. With a 100% transfer, many of the disadvantages listed in Section 4 do not apply. But existing liabilities and to a lesser extent existing title insurance, as discussed in Sections 4.3 and 4.4, may also be problems when all the ownership interests are sold.

26 The potential advantages described in the immediately preceding note may still be relevant and even more likely (e.g., the prospect of avoiding a reassessment or transfer tax, especially when selling a minority interest) in the case of a sale of only part of the ownership interests. But will they outweigh the disadvantages described in Section 4 ("Third-Party Membership Interest Sale")? In some cases, they might (e.g., if avoiding state or federal income taxes is a primary concern for an out-of-state or foreign investor).

27 Berg & Fisch, *supra* note 9; *see also* Hypothetical JV Sale Article, *supra* note 7, at § 5.1.3.

28 *See, e.g.*, *supra* note 1.

29 *See, e.g.*, 1 PALOMAR, TITLE INSURANCE LAW § 4:21, at 166–68 (Thomson Reuters 2015). Getting a so-called "partner" or "equity" policy may not be as simple as using an owner's ALTA 2006 form title policy (with the buyer as the named insured) and then attaching an ALTA Endorsement No. 15.2-06 (Non-imputation – Partial Equity Transfer). If the title company wants the policy amount to include LLC mortgage debt, then the buyer will want to include only a proportionate part of the debt (and will want to make sure any recovery by an insured lender will reduce the buyer's coverage by only the applicable proportion). Will the buyer be entitled to a proportionate part of the loss incurred by the LLC or will it need to provide independent proof that there was a loss to the buyer? And what if the buyer is acquiring preferred equity? Will the relevant recovery proportion be 100% or would the buyer be denied any recovery for a loss that is arguably borne by the subordinate member? And what happens if the buyer is unable to get the issuer of the *existing* title policy to issue an acceptable policy? Will it be able to get what it needs from another title insurance company, and if so, will it be more complicated? How will claims covered under both policies be addressed? Must a claim be made under the existing policy first?

30 *See, e.g.*, PALOMAR, *supra* note 29, at §§ 6:10–6:16, 8.5, 9:12; BURKE, LAW OF TITLE INSURANCE §§ 4.04–4.05, 10.08 (CCH 3d ed. 2016 supp.).

31 *See, e.g.*, Klein & Shepherd, *By the Way, What About the Post-Closing Credit Enhancement?*, 30 PROB. & PROP. 35 (May/June 2016).

32 *See, e.g.*, Marcks & Fisher, *Effective Use of Representations and Warranties Insurance Policies in M&A Transactions*, 28 CAL. BUS. L. PRAC. 33 (Spring 2013).

33 I.R.C. § 514(c)(9)(B)(vi); Kahn, *Help With Fractions: A Fractions Rule Primer*, TAX NOTES SPECIAL REP. 953 (Feb. 22, 2010).

34 When lockout periods are different, then the applicable exercise period should be defined separately for each member and references to the lockout period should indicate the member to which it relates.

35 Sample Provisions (Appendix A), § 12.5 ("Improper Notices").

36 *See also* § 6.4.2 ("Restarting Process on Expedited Basis") for discussion of right to restart ROFO process on an expedited basis.

37 Sample Provisions (Appendix A), § 12.2.2 ("First Offer Notice"), § 12.3.1 ("Buy/Sell Notice"), and § 12.4.1 ("Put/Call Notice").

38 Hypothetical JV Sale Article, *supra* note 7, § 2, at 8–10.

39 If there were separate distribution waterfalls for each of the properties, then a division might be much more evenhanded (and more palatable for the member who would name the prices and take the pricing risk) than triggering a buy/sell or unilateral sale right for each of the Properties individually. An alternative type of division in a 50/50 multi-asset venture is to have one of the members "cut the cake" into two pieces and let the other member choose one piece: one of the members could divide the properties (subject to various limitations depending on the facts) into (1) one group of properties, together with a cash receivable from the owner of the other group, and (2) the remaining group of properties, together with a payment obligation (to the owner of the other group)

equal to the hypothetical cash receivable (so that, if the dividing member thought one group of properties was worth $90X and the other was worth $100X, it could make the receivable and the payment obligation $5X to equalize the groups at $95X).

[40] Hypothetical JV Sale Article, *supra* note 7, § 1, at 3–6.

[41] When the non-initiating member makes the offer, the initiating member will still be testing the market with a floor price, and its marketing efforts may be for naught if the floor is perceived to be above market. This possibility puts pressure on the initiating member to spot a high offer, accept it and run the risk that it wasn't high after all. But it may be far less pressure than results from naming the price in the first place.

[42] Hypothetical JV Sale Article, *supra* note 7, at n.35.

[43] If the exit transaction takes the form of a disposition of REIT shares and is followed by a subsequent sale of the underlying real estate by such REIT (either in liquidation or otherwise), significant tax risks to the original disposition of REIT shares being respected as a stock sale for tax purposes can arise as a result of any asset sale "gross-up" to the stock sale consideration.

[44] *See* clause (b) of paragraph 1 ("Price vs. Value") of the optional provisions at the end of the Sample Provisions.

[45] *See* clause (a) of paragraph 1 ("Price vs. Value") of the optional provisions at the end of the Sample Provisions.

[46] *See, e.g.*, 6 Del. C. § 18-305(a) ("Each member . . . has the right, subject to such reasonable standards . . . as may be set forth in a limited liability company agreement or otherwise established . . . to obtain from the limited liability company . . . for any purpose reasonably related to the member's interest as a member . . . (1) True and full information regarding the status of the business and financial condition of the limited liability company . . . and (6) Other information regarding the affairs of the limited liability company as is just and reasonable." However, when does information received by a member constitute information of the LLC so that other members have a right to that information? Further, the rights under this statutory provision may be restricted in the LLC agreement. 6 Del. C. § 18-305(g)); Mickman v. Am. Int'l Processing, L.L.C., C.A. No. 3869-VCP, 2009 Del. Ch. LEXIS 134 (Del. Ch. July 28, 2009) (§ 18-305 is a default provision that, in this case, was replaced by the language in the LLC agreement). There may also be fiduciary disclosure duties. *See, e.g.*, Salm v. Feldstein, 20 A.D.3d 469, 470, 799 N.Y.S.2d 104, 105 (App. Div. 2005) (managing 50% member purchased the plaintiff's 50% member's interest for $5.1 million and then sold the JV's assets for $16 million two days later; "[A]s a co-member with the plaintiff, the defendant owed the plaintiff a fiduciary duty to make full disclosure of all material facts."); McGuire Children, LLC v. Huntress, 889 N.Y.S.2d 883 (Sup. Ct. 2009) (a managing member bought out another member and failed to disclose the terms of the simultaneous company transaction by which it obtained the funds to effect the buyout through which he allegedly made a significant profit; "[He] owed fiduciary duties to [such other member] and . . . in failing to disclose the [other] transaction . . . , he violated those duties."); Allen v. Devon Energy Holdings, L.L.C., 367 S.W.3d 355, 398 (Tex. App. 2012) (two years after the minority member redeemed his interest, the JV was sold for almost 20 times the value used to calculate the redemption price; court overruled summary judgment denying breach of fiduciary duty claim). But fiduciary disclosure duties may be eliminated in Delaware. *See, e.g.*, *infra* note 76; Dieckman v. Regency GP LP, C.A. No. 11130-CB, 2016 Del. Ch. LEXIS 54, at 3–4 (Mar. 29, 2016) (acquisition of an entity by an affiliated entity alleged to favor interests of common interests to the detriment of other interests without disclosure of all material facts; in dismissing the plaintiff's claims, the court stated that "[b]y eliminating all fiduciary duties, . . . limited partnership agreement extinguished the common law duty of disclosure . . . . Even the implied covenant of good faith and fair dealing will not create additional disclosure obligations" where agreement addressed disclosure (with limited obligation to share a copy of merger agreement before the voting)).

[47] *See* paragraph 2 ("Express Disclosure Obligations") of the optional provisions at the end of the Sample Provisions.

[48] *See, e.g.*, Surkin, *When Joint Venturers Can't Agree – The Buy-Sell Revisited*, ACREL PAPERS, Tab 1, EMS 1 (Pt. VI: "Venturers' Duties") (May 8, 1998) (positing that the members "may both prefer that (although 'fraudulent' conduct will never be allowed), once the buy-sell gauntlet is thrown, each venturer should be 'on its own'."); Stein, *It Seemed Like a Good Idea at the Time: Rights of First Offer and First Refusal: First Rights Can Cause More Problems Than They Solve*, 42 N.Y. REAL PROP. L.J. 6, at n.35 (Fall 2014) ("[A]ll is fair in love and real estate.").

[49] Thus, this approach would not work (1) in the variant of the ROFO in which the non-initiating member makes the offer, (2) in the Buy/Sell, when the non-initiating member elects to sell, and (3) in the Put/Call, when the initiating member is the selling member.

[50] Sample Provisions (Appendix A), § 13.2.1 ("Member Sale Deposit").

[51] *See, e.g.*, Carey, *Five Joint Venture Calculation Issues That May Be Overlooked or Misunderstood*, 28 CAL. BUS. L. PRAC. 17, 19–20 (Winter 2013) ("Buy-Sell, Drag-Along, and Tag-Along Conundrums").

[52] A similar problem may arise in connection with a right of refusal, which may not be triggered by a third-party offer unless the owner *desires* or *decides* to accept the offer. *See, e.g.*, 3 CORBIN ON CONTRACTS § 11.3, at 470 (rev. ed. 1996; Spring 2016 supp.) ("[O]wner's receipt of an offer and the good-faith decision to accept it . . . 'triggers' the right of first refusal . . . ."). As observed by one commentator, "The phrase '[s]hould any party desire to sell . . .' is ambiguous and requires trying to nail down with

specificity the first time when a property owner 'desires' to sell . . . ." Sergesketter, *Preferential Rights to Purchase: The Basics, and the Most Interesting Pref. Rights Case You've Never Heard About*, 5 HLRe: OFF THE RECORD 43, 58 (2015).

53 *See, e.g.*, Constellation Dev., LLC v. Western Trust Co., 882 N.W.2d 238, 240 (2016) ("If Seller decides to sell more land the Buyer will have 14 days to enter into a Purchase Agreement [at $18,000 per acre] and 30 days to close . . . ."); B. Boman & Co., Inc. v. Zionist Org. of Am., 2015 N.Y. Misc. LEXIS 3478, N.Y. Slip Op. 31809(U) (Sup. Ct.) (unpublished) ("If [the owner] desires to sell the [property] it shall, prior thereto, first . . . give written notice of . . . the 'Acceptable Price' [and certain other terms]."); Delco Dev. of Port Washington, L.P. v. Stop & Shop Supermarket Co., 2009 N.Y. Misc. LEXIS 4169, N.Y. Slip Op. 31897(U) ("If [either party] ever proposes or desires to sell all or any portion of its interest in the Shopping Center (such party being hereafter deemed 'Seller'), Seller shall give the other party . . . written notice of such intention, which notice . . . shall set forth all material terms and conditions of such proposed sale . . . and shall constitute an offer . . . ."); RCM LS II, LLC v. Lincoln Circle Associates, LLC, C.A. No. 9478-VCL, 2014 Del. Ch. LEXIS 133, at 4–5 (July 28, 2014) (unpublished) ("If . . . an Owner desires . . . to the sell the Property . . . , then prior to . . . effecting a sale to a third party . . . , the Owner . . . shall first give to [the holder] notice [which] must state the sale price, closing date . . . , all material economic terms and all other material terms . . . .").

54 Constellation, *supra* note 53, at 243; *see also* B. Boman, *supra* note 53, at 9 ("the right of first offer language . . . requires [the owner] to give notice when it desired to sell"); *cf.* RCM, *supra* note 53, at 19–21 ("once [the owner] decided to sell . . . , he was obligated to 'first give to [the holder] notice . . .'" and "once [the owner] decided to sell the Property and knew the price and structure, [the owner] was obligated to send the Property Offer Notice before proceeding further with a third party").

55 The Constellation case is also unusual because it was the owner, not the holder, who was trying to establish that the ROFO had been triggered (and that it was *not* timely exercised). It was clear that the owner intended to sell because the parties had entered into a purchase agreement. But the holder defaulted under that purchase agreement and then tried to resurrect the ROFO as a ROFR (which it was mistakenly called) when the owner subsequently entered into another contract with a third party.

56 *See, e.g.*, Long v. Wayble, 618 P.2d 22 (1980) (in a case involving a ROFR at a fixed price, listing agreement was sufficient to establish decision to sell); *cf.* Estate of Johnson v. Carr, 706 S.W.2d 388, 390 (1986) (in which a letter indicating that the seller was "seriously considering" selling was not sufficient – and in which the price was capped but not fixed).

57 B. Boman, *supra* note 53, at 9–10 (an appraisal and a blast marketing email did not constitute a desire to sell; there was "nothing in the right of first offer language that precludes [the seller] from researching the value of the Property by an appraisal or any other means before it decides that it 'desires to sell' for a given minimum price" and it "could not make any decision to sell without authorization from the board"); Delco, *supra* note 53 (the provision did not prohibit "the defendant from listing or marketing the subject property nor does it prevent the defendant from exchanging drafts or agreements with any third-parties [sic]"); *c.f.* Riverside Surgery Ctr., LLC v. Methodist Health Sys., 182 S.W.3d 805 (2005) (an LLC agreement had a variation of a ROFO that entitled and required a member desiring to sell its interest to first offer its interest to the other members at a price based on the net book value of the company; the ROFO was triggered when a member entered into an option/ROFR agreement with a third party even though it was subject to the ROFO). *See also* RCM, *supra* note 53, at 21 (stating, in dicta, that the owner could "test the market to inform himself about whether to sell and on what terms" and "could explore potential transactions and possible structures with third parties" until "he decided to sell the Property and knew the price and structure").

58 *See, e.g.*, B. Boman, *supra* note 53, at 9 ("Until [the owner] had done some investigating and marketing and came to the point where it could propose a minimum purchase price, it did not have the desire to sell.").

59 Stephens v. Trust for Pub. Land, 479 F. Supp. 2d 1341, 1347–49 (2007) (ROFO provided that "[a]t any time . . . Seller desires to sell . . . , before offering . . . or listing the same . . . , Seller shall give Buyer a Notice . . ." and court found that "the plain language . . . places no restrictions upon the time when Seller's Notice must be given, and certainly does not . . . obligate [Seller] to give Seller's Notice immediately upon her formation of some subjective desire to sell . . . .").

60 RCM, *supra* note 53, at 19–20. The court also stated (at 21) that "a sophisticated real estate investor . . . is charged with understanding the meaning of the term 'right of first offer'" and (at 18) that a "'reasonable person' interpreting a contract is 'bound by usages of the terms which either party knows or has reason to know.'" [citation omitted].

61 The quote is from a D.C. case involving statutory purchase rights in favor of residential tenants and leaves out the words ", as it [the ROFO] usually appears in leases," and, in that case, the statement is supported by an article on the economics of rights of first refusal, which merely says "[i]f the lessor decides to sell the property during the term of the lease, perhaps after preliminary discussions with potential buyers, the lessee will be given notice and a specified period during which to make an offer to purchase," which is a different variant of ROFO. Aside from the D.C. case, the Delaware court cites the same economic article cited in the D.C. case and another economic article which states (with no citations) in similarly bold fashion: "A right of first offer requires a seller who wishes to sell an asset, subject to such right, to offer the right-holder to buy that asset before it is offered to other potential buyers."

62 *See, e.g.*, Bill Signs Trucking, LLC v. Signs Family Limited Partnership, 157 Cal. App. 4th 1515, 1522–23 (2007); MC Oil & Gas, LLC v. Ultra Res., Inc., 145 F. Supp. 3d 1066, n.32 (2015).

63 GREENWALD & BANK, CALIFORNIA PRACTICE GUIDE: REAL PROPERTY TRANSACTIONS ¶ 8:6, at 8-2 (The Rutter Group 2015); the cited paragraph in the Bill Signs case, *supra* note 62, is ¶ 8:208, at 8-47, which has slightly different wording: "[In] a 'right of first offer' . . . the seller, upon deciding to market its property, must first make an offer to the grantee . . . ."

64 *See* RCM, *supra* note 53, at 19–20 (court found that the "decision" to sell, which triggered the obligation to first make an offer to the holder, occurred no later than the time an LOI was signed and that a "right of first offer . . . prohibits the owner from negotiating a transaction with a third party until the property has been offered to the right-holder"); Riverside, *supra* note 57; *but see* Stephens, *supra* note 59, in which the court focused on enforceability, which could allow for non-binding letters of intent. In that case, the court found that the ROFO was intended to be triggered by the seller's notice and not by solicitation and receipt of an offer, which is not a legally enforceable offer to sell.

65 *See* RCM, *supra* note 53, at 4. This case involved egregious facts that may have led to a broader interpretation of the rights of the holder of the ROFO than might otherwise have been justified. But any bias the court might have had may nonetheless be helpful in understanding the potential mindset of the holder of a ROFO anxious to preserve its ability to acquire the property.

66 *See* RCM, *supra* note 53, at 21. This may be a case of bad facts making bad law. (The opinion also reflects a lack of understanding of preemptive rights: finding (at 22) that the owner was trying to convert a "right of first *offer* into a disadvantaged right of first *refusal*" as if the holder would be disadvantaged to have a ROFR instead of a ROFO.) But it is a sobering reminder of the hurdles one might face when trying to enforce a unilateral sale right subject to a ROFO.

67 RCM, *supra* note 53, at 21–23.

68 *See, e.g.*, Kelly v. Ammex Tax & Duty Free Shops W., Inc., 256 P.3d 1255, 1257 (2011) (the ROFO required that an "offer . . . shall be submitted to [the holder] before [the owner] enters into negotiations with any independent third party") and 1259 (the court concluded that "[under this] process . . . [the owner] could not then . . . test the market and solicit offers until it first offered the property to [the holder]"); Stephens, *supra* note 59, at 1347 (The seller agreed to make an offer to sell the property at an appraised value at "any time . . . Seller desires to sell [the property] before offering the [property] or listing the same for sale . . . .").

69 Stephens, *supra* note 59, at 1352 (The court stated that solicitation and receipt of an offer is not a legally enforceable offer to sell, and that there was no evidence of any listing agreement with a broker).

70 Sample Provisions (Appendix A), §§ 12.1.1 ("ROFO"), 12.2.1 ("Commencing ROFO Process").

71 MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY (n.d. Web Oct. 29, 2016), *available at https://www.merriamwebster.com/dictionary/consummate.html*. *See also* BLACK'S LAW DICTIONARY (10th ed. 2014) ("consummate" means "1. To bring to completion . . . .").

72 The RCM and Delco cases are consistent with the author's experience: RCM, *supra* note 53, at 5 (225 days); Delco, *supra* note 53, at 2 (12 months).

73 Sample Provisions (Appendix A), § 12.1.2 ("Closing").

74 Sample Provisions (Appendix A), § 12.1.3 ("Affiliates").

75 *See* paragraph 3 ("Unilateral Sales to Affiliates") of the optional provisions at the end of the Sample Provisions.

76 Since 2004, the Delaware LLC Act has made clear that fiduciary duties may be eliminated in a Delaware LLC agreement (but an LLC agreement may not eliminate the implied contractual covenant of good faith and fair dealing). 6 Del. C. § 18-1101(c). And since 2013, the Delaware LLC Act has been clear that default fiduciary duties may apply in the absence of LLC provisions to the contrary. 6 Del. C. § 18-1104. The following cases are examples where default fiduciary duties, contractual fiduciary duties or the implied covenant were used to attack transfers to affiliates: *In re* Atlas Energy Resources, LLC, C.A. No. 4589-VCN, 2010 Del. Ch. LEXIS 216 (Del. Ch. Oct. 28, 2010) (alleged pricing for the acquisition by merger of a publicly traded LLC by the LLC's controlling unitholder was not entirely fair to the public unitholders and therefore the controlling unitholder's motion to dismiss claim for breach of fiduciary duty was denied); Gatz Properties, LLC v. Auriga Capital Corp., 59 A.3d 1206, 1213 (Del. Nov. 7, 2012) (LLC provision requiring approval of affiliate transactions that are less favorable than a third-party arm's-length transaction "imposed fiduciary duties in transactions between the LLC and affiliated persons. . . . [T]here is no requirement in Delaware that an LLC agreement use magic words, such as . . . 'fiduciary duties.' [The LLC agreement required] the manager and other members to obtain a fair price for the LLC in transactions between the LLC and affiliated persons."); Gerber v. Enterprise Products Holdings, LLC, 67 A.3d 400, 422 (Del. 2013) (a disposition to an affiliate, allegedly for only 9% of the acquisition cost, which relied on a fairness opinion that did not address the value of the consideration received, was "arbitrary, unreasonable conduct that the implied covenant prohibits"); *but see also supra* note 46.

77 *See, e.g.*, RCM, *supra* note 53, at 5 (3%); Delco, *supra* note 53, at 2 (5%).

78 Sample Provisions (Appendix A), § 12.1.4 ("Amount of Purchase Price").

[79] *See* paragraph 6 ("Restricting the Use of the ROFO Margin of Error") of the optional provisions at the end of the Sample Provisions.

[80] *See* paragraph 4.1 ("Expedited Restart of ROFO Process") of the optional provisions at the end of the Sample Provisions.

[81] *See* paragraph 4.2 ("Making the Non-Initiating Member Whole") of the optional provisions at the end of the Sample Provisions.

[82] *See, e.g.*, paragraph 5 ("Allowing Loan Assumption in Unilateral Sale") of the optional provisions at the end of the Sample Provisions.

[83] For example, assume the following facts: (a) the property is subject to an $80X loan (which is unfavorable), (b) the property has a fair market value of $100X without the debt and $99X with the debt, (c) the assumption fee is $1X and the prepayment fee is $4X, (d) under the ROFO, a price of $100X is named and there is a minimum required price of $99X. Now compare what happens with (1) a buyer who will agree to buy the property for $98X and assume the loan, and (2) a buyer who will agree to buy the property for $100X and pay off the loan, where in each case the venture must pay the loan satisfaction/assumption costs (the first buyer would also be willing to buy for $97X and pay the assumption fee): only a sale to the second buyer is permitted even though it yields less cash proceeds to the venture ($16X vs. $17X before other closing costs).

[84] *See* Hypothetical JV Sale Article, *supra* note 7, § 5.2.2, at 18 (Net vs. Gross Prices). *See also ibid.* at n.50 for an example that illustrates a different point, but may be useful to appreciate the problems with estimates in this context. Not knowing whether there will be an assumption creates a greater risk of a bad estimate, which could make the comparison unworkable and potentially jeopardize the initiating member's marketing efforts. Why not name two prices, one with, and one without, a loan assumption? But should the purchasing member be able to take advantage of a lower price associated with paying off the loan without paying off the loan? Would a membership interest purchase option that requires a payoff of the loan be a viable option? If the loan payoff pricing is not available to the purchasing member, would it invite manipulative pricing for the loan payoff alternative?

[85] *See* Hypothetical JV Sale Article, *supra* note 7, at n.53.

[86] A buyer might name a price that will decrease only to the extent the defeasance costs exceed a certain assumed amount, but this approach may be messy. Another consideration is that, although there may be a transfer tax and real estate tax cost in doing so, it is conceivable that the buyer may prefer to state a higher price and have the seller pay more costs (e.g., to be able to present to a lender or subsequent buyer a higher stated purchase price).

[87] Regardless of whether the property is sold to a third-party buyer or the other member, the initiating member may end up with less. In an attempt to address the problem of the non-initiating member getting too good a deal, some professionals have provided that the purchasing member must pay all the loan assumption or satisfaction costs payable in connection with an inter-member sale. However, in many deals, the inter-member sale is permitted by the loan documents (so it doesn't result in any meaningful loan assumption or satisfaction costs).

[88] *See* paragraph 5.2 ("Loan Guaranties") of the optional provisions at the end of the Sample Provisions, which addresses this point by incorporating the corresponding guaranty provisions from the inter-member sale provisions.

[89] *See, e.g.*, Katz, *supra* note 9, at Appendix C ("The ROFO Sale Notice shall specify the purchase price . . . and the economic and other material terms of the proposed sale . . . .") and Appendix D ("(i) the purchase price . . . and (ii) other material terms . . ."); Murray, *Options and Related Rights with Respect to Real Estate: An Update*, 47 REAL PROP. TR. & EST. L.J. 63, 139 (Spring 2012) ("[T]he Owners agree to first offer the Land . . . by giving written notice . . . of the terms and conditions on which the Owners are willing to sell the Land."); CALIFORNIA REAL PROPERTY SALES TRANSACTIONS, at 8-52 (CEB 4th ed. 2016) ("Offeror shall deliver a notice . . . stating . . . the price, terms, and conditions on which it proposes to sell the Property.").

[90] *See, e.g.,* Delco, *supra* note 53, at 2 (the ROFO holder sent a letter challenging the ROFO notice asserting that it "fails to set forth all material terms and conditions" as required); *see* RCM, *supra* note 53, at 13–14 (The ROFO holder "sent a letter . . . disputing the effectiveness of the Property Offer Notice . . . [The holder] objected that the Property Offer Notice failed to disclose all material terms of the proposed transaction.").

[91] *See, e.g.*, SKI, Ltd. v. Mountainside Props., 114 A.3d 1169 (Vt. 2015) (conditioned offer on forfeiting any right to challenge development by another landowner); RCM, *supra* note 53, at 11–13 (offer included over 1,000 pages of exhibits).

[92] Sample Provisions (Appendix A), § 12.1.5 ("Manner of Payment").

[93] *See, e.g.*, Circo, *Purchase Options, ROFRs, and ROFOs: Theory and Practice*, ACREL PAPERS, Tab 11, 285, 317 (Spring 2016) ("The duty of good faith and fair dealing potentially has especially sharp teeth in some disputes stemming from options, ROFRs, and ROFOs."). *See also* Shepherd, *Rights of First Refusal: Poison Pills and Bad Faith*, 21 PROB. & PROP. 52 (May/June 2007); *cf.* SKI, *supra* note 91, at 1177, which found it unnecessary to address a claim for breach of the covenant of good faith and fair dealing because it concluded as a matter of contract interpretation that conditioning the offer on an agreement not to contest development by another landowner did not provide the holder "with the benefit it reasonably expected" under the ROFO.

[94] Sample Provisions (Appendix A), § 12.1.7 ("Authority"). *See also* paragraph 7 ("Authority to Sell the Property") of the optional provisions at the end of the Sample Provisions, which requires the non-initiating member to confirm such authority and the waiver of its right of first offer for the applicable sale.

[95] CORBIN, *supra* note 52, § 11.4, at 487. Many preemptive rights, which Corbin covers "under the generic caption 'rights of first refusal,'" are "often mistakenly referred to as Options." CORBIN, *supra*, § 11.3, at 468–69; Kutkowski v. Princeville Prince Golf Course, LLC, 129 Haw. 350, 351–52 (2013) (a type of ROFO, which provided that the owner first offer the property to the other party if it decides to sell the property, was initially mischaracterized by the parties as an "option to purchase" and later mischaracterized at trial by the parties and the court as "really a 'right of first refusal' ('ROFR')"); Metropolitan Transp. Authority v. Bruken Realty Corp., 67 N.Y.2d 156, 163 (1986) (court found that the parties had mischaracterized a "preemptive right" as an "option" and then the court equated a preemptive right with a "right of first refusal," while describing it in a manner that would encompass either a right of first refusal or a variant of a right of first offer: "requires the owner, when and if he decides to sell, to offer the property first to the party holding the preemptive right so that he may meet a third-party offer or buy the property at some other price set by a previously stipulated method"); Stuart v. D'Ascenz, 22 P.3d 540, 541–42 (Colo. App. 2000) (court described a ROFR as though it were a ROFO: a "right of first refusal . . . merely requires the owner, when and if he or she decides to sell, to offer the property first to the holder."); Fannie Mae defines a "right of first refusal" as though it were a ROFO: "A provision in an agreement that requires the owner of a property to give another party the first opportunity to purchase or lease the property before he or she offers it for sale or lease to others." Fannie Mae Single Family Selling Guide Glossary E-3, at E-18 (Aug. 30, 2016), *available at* https://www.fanniemae.com/content/guide/selling/e/3/glossary.html. As one author stated, "What's a ROFO? What's a ROFR? Clients throw these acronyms around rather loosely . . . . In common parlance, the term ROFR often captures a ROFO as well." Stein, *supra* note 48, at 7.

[96] *See, e.g.*, Kahan, *An Economic Analysis of Rights of First Refusal*, N.Y.U. CENTER FOR LAW AND BUSINESS, Working Paper No. 99-009, at 4 (June 1999) (hereinafter, "Kahan (1999)") ("A right of first refusal requires the owner . . . to offer the property to the rightholder on the same terms as those offered by that third party before the owner can sell the property to that third party"); Murray, *supra* note 89, at 70 ("[I]f and when the [owner] decides to sell . . . to any third party, the holder . . . can require the owner to sell . . . to him the same price and terms . . . ."). As noted in the body of the article, rights of first refusal mean different things to different people. And descriptions of rights of first refusal, taken out of context, may be confusing. *See supra* note 95.

[97] *See, e.g.*, Murray, *supra* note 89, at 76 ("The holder of an RFO has the first right to make an offer . . . before the owner can sell the property to a third party. The owner then has a specific period to accept or reject the offer. If the owner rejects the offer, he is free to sell . . . with the only restriction being that he cannot accept a price less than (or in some cases less than a percentage of) the price offered by the holder . . . ."); Rutter & Montgomery, *Options, Rights of First Refusal, Rights of First Negotiation and Rights of First Offer: A Guide Though the Maze*, CORP. REAL EST. & THE LAW 7 (Summer 1999), *also available at* http://www.gilchristrutter.com/CM/Articles/Options,%20Rights%20of% 20First%20Refusal.pdf (with almost the same text as that quoted above from Murray); Hosford, *Options and Rights of Refusal*, ST. B. TEX. 17TH ANN. ADVANCED REAL EST. DRAFTING COURSE, Ch. 11, at 2 (Mar. 9–10, 2006), *available at* http://www.texasbarcle.com/materials/events/5853/44891_01.pdf ("[T]he owner . . . must notify the holder before offering the asset to any third party . . . and the holder has the first right to make an offer, which owner must accept or reject in a specified period of time. . . . A common permutation is to provide that the owner's notice to the holder will specify the price and terms owner is willing to accept."); Kahan (1999), *supra* note 96, at 4 ("[T]he rightholder must be given the chance to make an offer for the property. The owner can then either accept . . . or . . . sell . . . to a third party, but only at a price above the one offered . . . ."); Katz, *supra* note 9, at 6 (who describes a ROFO as a right to receive an offer which if rejected creates a floor price for a third-party sale subject to a possible margin of error, and then describes a "Reverse ROFO," which has the holder making the offer); Walker, *Rethinking Rights of First Refusal*, 5 STAN. J.L. BUS. & FIN. 1, 9–10 (Spring 1999) ("[T]he [holder] will be given notice and a specified period during which to make an offer to purchase. The owner may accept the offer or may, within a specified period, sell to a third party . . . [but not] for a price that is less than that offered . . . ."); *see* CALIFORNIA REAL PROPERTY SALES TRANSACTIONS, *supra* note 89, § 8.82, at 8-52 (setting forth a form for a ROFO, under which the holder makes an offer that sets a floor price if not accepted); Blumenfeld & Rowe, *Consider a Counteroffer They Can't Refuse – An Alternative to Options, Rights of First Refusal, and Rights of First Offer*, 30 REAL EST. REV. 40, 42 (Summer 2000) ("In a ROFO, the landlord is obligated to offer any available space in the building to the tenant *before* offering it to a third party. . . . [I]t is not uncommon to provide that if the tenant refuses . . . , the landlord cannot then lease . . . to a third party on materially better terms [or simply for] rent which is less than some percent (say, 95%) of the rent originally offered . . . ."); Berg & Fisch *supra* note 9 (describing a ROFO as a right of the holder to receive an offer which if rejected prohibits the owner from selling on materially better terms); Steiner, *Hold Your Horses Before You Close That Deal: Rights of First Offer, Rights of First Refusal, and Options*, ACREL PAPERS, Tab 10, 227 (Spring 2016) (A "**ROFO – Right of First Offer** – Sometimes called a 'right of first opportunity.' It gives the Holder the opportunity to respond to an offer the Grantor is willing to make to (or accept from) the Holder . . . .").

[98] *See, e.g.*, Murray, *supra* note 89, at 75–76 ("[T]he owner must notify the right's holder that the owner intends to sell . . . . The parties then have a specified period of time to negotiate, on an exclusive basis . . . . If the exclusive negotiation period lapses without an agreement . . . , the owner generally is free to sell . . . free and clear of the rights of the holder . . . ."); Rutter &

Montgomery, *supra* note 97, at 3 (with similar text as that quoted above from Murray); Hosford, *supra* note 97, at 2 ("When the owner 'intends' to sell . . . , owner must notify the holder, and the parties have a specified period of time in which to negotiate exclusively, after which the owner may offer the asset to third parties free of the right.").

99 Circo, *supra* note 93, at 288 (describing options, ROFRs and ROFOs); *see also* GREENWALD, *supra* note 63, § 8:6, at 8-2 ("A 'right of first offer' also gives the prospective buyer a *preemptive* right to purchase . . . .").

100 *See, e.g.*, Constellation, *supra* note 53, at 240 ($18K per acre).

101 *See, e.g.*, Metropolitan, *supra* note 95, at 160 ("arbitration of the market value"); Riverside, *supra* note 57 (price based on the "net book value" of the company).

102 Even in the context of other types of ventures (e.g., family partnerships and other ventures among individuals with preexisting relationships who want to impose severe restrictions at the ownership level to limit the introduction of new owners), the custom and practice may be different.

103 *See, e.g.*, Steiner, *supra* note 97, at 230 (In response to a poll among the members of the ACREL Leasing Committee, it was estimated that ROFRs are used in approximately 13% of commercial leases).

104 In the author's experience, a land developer may require both a repurchase option and a ROFO for any lot sold to a builder on which the builder doesn't build a residence: the repurchase option would be at cost (to encourage the builder to build before the commencement of the option period and to effectively eliminate the ability to flip an unimproved lot for a profit and possibly compete with the seller if it is still selling land); and the ROFR would provide additional protection to the seller in a down market or a fire sale situation.

105 *See, e.g.*, 8 POWELL ON REAL PROPERTY § 54A.05[4][a] (Matthew Bender 2016); RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 3.4 cmt. g (2000) (Am. Law Institute 2000).

106 Rights of first negotiation may be useful if third-party sales may not be comparable. For example, a home-builder who sells land to land developers when it has too much land on its books may want a ROFO so it has the opportunity to reacquire the land if it is ready to build when the developer is ready to sell the land. But comparison may be very difficult because of the numerous potential variations in sale terms that depend on the particular buyer and its particular needs (including selection of lots, whether there will be purchase money financing and the take-down schedule, to name a few). Some tracts may be multi-builder tracts (which are expected to be sold and marketed to multiple builders) where the builders may want to get together, divide the tracts into groups and draw straws (which would make it very difficult to make a comparable inter-member offer). *See* NELSON & WHITMAN, REAL ESTATE TRANSFER, FINANCE, AND DEVELOPMENT, Ch. 9, at 1017–19 (5th ed. 1998), which mentions no less than "six major types of [land] option arrangements." While discount formulas and other mechanisms can be used in an attempt to make terms comparable, they may not make as much sense at the time they are applied and there will likely be ample room for arguments or potential windfalls. A right of first negotiation may turn out to be more effective and even-handed.

107 *See, e.g.*, Circo, *supra* note 93, at 297 ("ROFRs 'produce negotiating, drafting and dispute related costs,' and . . . they tend to discourage third-party offers." [footnote omitted]); and it should be obvious that an option is more restrictive than a ROFR, because a ROFR may allow "the owner of the asset to decide whether and when to sell . . . ." Murray, *supra* note 89, at 71.

108 *See, e.g.*, Kahan, Leshem & Sundaram, *First-Purchase Rights: Rights of First Refusal and Rights of First Offer*, 14 AMER. L. & ECON. REV. 331, at 27 (2012). One might wonder whether a member should be entitled to a ROFR if it is willing to bear the cost of the breakup fee and some initial cost for *any* bidder to encourage participation. But how do you establish an acceptable breakup fee and initial reimbursement in advance? And will some, if not many, buyers be unwilling to spend the time (even with reimbursement) if there is a good chance that (x) they will not be the winning bidder or (y) the ROFR will be exercised?

109 Gosfield, *A Primer on Real Estate Options*, 35 REAL PROP. PROB. & TR. J. 129, 163 (Spring 2000).

110 *See, e.g.*, Blumenfeld & Rowe, *supra* note 97, at 40; and Goldman, *Drafting a Fair Right of First Offer Lease Option (with Form)*, 11 PRAC. REAL EST. LAW. 79 (Jan. 1995). *See also supra* note 97.

111 *See, e.g.*, Kahan (1999), *supra* note 96, at 4, which states that a "right of first offer [requires that] the rightholder . . . be given the chance to make an offer for the property"; and Murray, *supra* note 89, at 76, which (tracking the description provided in 1999 by Rutter & Montgomery, *supra* note 97), states that the "holder of [a right of first offer] has the first right to make an offer for the purchase of the property before the owner can sell the property to a third party," while recognizing that it is also possible to require the owner to make the first offer. *See also supra* note 97.

112 Circo, *supra* note 93, at 296.

113 When one member wants to buy and the other wants to sell, the former member seems like the logical buyer and it would appear that a natural exit would be a Put/Call. But the member who desires to sell may want the benefit of a fully marketed sale and the

other member may want the benefit of an off-market deal. This issue can be particularly challenging when dealing with members who have equal bargaining power.

[114] For more on Buy/Sells, *see* Carey, *Buy/Sell Provisions in Real Estate Joint Venture Agreements*, 39 REAL PROP. PROB. & TR. J. 651, 663–65 (Winter 2005).

[115] The inter-member sale provisions involve a pricing mechanism (to establish the price of the selling member's membership interest) based on a hypothetical sale of the Property that is discussed in detail in the Hypothetical JV Sale Article, *supra* note 7.

[116] *See* discussion in § 5.1 ("Lockout Periods: When Is Exit Right Available?").

[117] *See supra* note 2.

[118] *See* discussion in § 5.3 ("What Is Being Priced or Valued?") and § 5.4 ("Multiple Property Deals").

[119] *See* discussion in § 6.1 ("Timing: To What Extent May Sale Process Precede ROFO Process?").

[120] The Unilateral Sale Closing Period varies from transaction to transaction and depends on a number of factors including the status and complexity of the Property. *See* § 5.2 ("Length of Offer, Election and Closing Periods"), § 6.2 ("Timing: When Must Sale Process End?").

[121] *See* discussion in § 6.3 ("Who May Buy?").

[122] *See* discussion in § 6.4 ("Amount of Purchase Price").

[123] *See* discussion in § 6.5 ("Manner of Payment: All Cash vs. Loan Assumption").

[124] *Ibid*.

[125] *See* discussion in § 6.6 ("Other Terms of Sale").

[126] *See* discussion in § 6.7 ("Authority").

[127] *See* discussion in § 7.3 ("ROFO – Who Makes the Offer?").

[128] *See* discussion in § 6.1 ("Timing: To What Extent May Sale Process Precede ROFO Process?").

[129] *See* discussion in § 5.2 ("Length of Offer, Election and Closing Periods").

[130] *See* discussion in § 6.5 ("Manner of Payment: All Cash vs. Loan Assumption") and § 6.6 ("Other Terms of Sale").

[131] *See* discussion in § 5.3 ("What Is Being Priced or Valued?") and § 5.4 ("Multiple Property Deals").

[132] *See* discussion in § 5.2 ("Length of Offer, Election and Closing Periods").

[133] *See* discussion in § 5.7 ("Deposit for Inter-Member Sale").

[134] *See supra* note 2.

[135] *See* § 5.3 ("What Is Being Priced or Valued?") and § 5.4 ("Multiple Property Deals").

[136] *See* discussion in § 5.1 ("Lockout Periods: When Is Exit Right Available?"). The right to trigger the buy/sell is sometimes limited to certain non-consecutive periods of time (e.g., 60 days after the members reach a deadlock over a Major Decision).

[137] *See* discussion in § 5.2 ("Length of Offer, Election and Closing Periods").

[138] *See supra* note 2.

[139] *See* § 5.3 ("What Is Being Priced or Valued?") and § 5.4 ("Multiple Property Deals").

[140] The exhibit would typically contain an appraisal or other valuation process. *See, e.g.*, some of the alternatives described in the discussion captioned "Valuation Process: Appraisal/Averaging" in Appendix B of the Hypothetical JV Sale Article, *supra* note 7.

[141] *See* discussion in § 5.1 ("Lockout Periods: When Is Exit Right Available?").

[142] *See* paragraph 8 ("Improper Notices – Abuse of Process") in the optional provisions at the end of the Sample Provisions for additional provisions that might be considered if a member is worried about an attempt to abuse the process in certain circumstances.

[143] The members may agree on other events that preclude commencement of one or more of these procedures. For example, the members may not want these procedures commenced while trying to refinance the Property if it may interfere with the refinancing process. On the other hand, one or more of these procedures may be prescribed as a dispute resolution mechanism if refinancing is a unanimous decision over which the members are deadlocked.

144 *See* discussion in § 5.2 ("Length of Offer, Election and Closing Periods").

145 The words "and the other assets of the Company" would not be used if there were all-asset pricing (instead of the Property pricing which is assumed in this Article). *See supra* note 3.

146 The preceding sentence may be necessary if there is internal debt or a clawback or other obligation to share losses that would have occurred in an actual third-party sale, but otherwise may not be required.

147 *See* discussion in § 5.7 ("Deposit for Inter-Member Sale").

148 Many venture agreements provide for a discounted price (e.g., 90%). Query whether and how such a discount impacts the liquidated damages analysis?

149 Identify the section, if any, of the LLC agreement under which each member indemnifies the other member or the Company, or both, for its wrongful acts or omissions.

150 *See* discussion in the Hypothetical JV Sale Article, *supra* note 7, § 5.2. For example, as suggested by Appendix D to, and the examples in Sections 5.2.4 and 5.2.5 of, the Hypothetical JV Sale Article, different closing adjustments would be required for *all-asset* pricing.

151 Identify the appropriate section of the LLC agreement under which the members would make this contribution.

152 Remember that it is assumed (for simplicity) that there is only one Property (i.e., no other real estate) so no additional real estate (other than ancillary real estate to expand the Property) would be acquired during the Member Sale Closing Period.

153 It is possible to limit this adjustment to capital expenditures that *expand* or *improve* the Property. It is also possible to narrow the applicable category of capital expenditures to those that are not expected to be recouped from tenant reimbursements, but the selling member is not likely to get the benefit of such tenant reimbursements. Consider whether it is advisable to define capital expenditure.

154 This streamline approach is intended to facilitate a quick and final sale. In some circumstances, it may not be appropriate.

155 Identify the section of the LLC agreement under which the Company indemnifies each member (e.g., for claims against a member for Company liabilities that were not caused by such member's wrongful acts or omissions).

156 *See* Section 10.7 of the Sample Provisions in Appendix A, and the discussion under the heading "PROPERTY SALE" in Appendix B, to Hypothetical JV Sale Article).

157 The prototype drop and swap involves a distribution of undivided interests to both members. A variant of the drop and swap involves a distribution to the non-exchanging member only, presumably because this avoids any issue with the intent to hold the relinquished property for investment. *See* WELLER & DRUCKER, REAL PROPERTY EXCHANGES § 7.8, at 7-12 (CEB 3d ed. 2015). However, the non-exchanging member may not want to take title to any real estate, so it may suggest that an undivided interest be distributed to the exchanging member only, in which event the exchanging member and the LLC would be co-tenants.

158 *See, e.g.*, WELLER & DRUCKER, *supra* note 157, §§ 2.14A, at 2-16, 7.6 *et seq.*; Lipton & Gruen, *The 'State of the Art' in Like-Kind Exchanges, 2012*, 116 J. TAX'N 246, 272–82 (May 2012); Medinets, *Dropping Co-Owners During 1031 Exchanges*, 231 N.Y. L.J. 39 (June 27, 2005); Chan, *Drop and Swap: Can You Relax if the Police Aren't Looking for You?*, 1 CAL. ST. NORTHRIDGE TAX DEV. J. 1 (Aug. 2009).

159 *See* WELLER & DRUCKER, *supra* note 157, § 7.6 *et seq.*; Lipton & Gruen, *supra* note 158, at 272–82.

160 I.R.C. § 1031(a)(1).

161 *See* WELLER & DRUCKER, *supra* note 157, §§ 7.10A, 7.10B; PLR 9645005 (July 23, 1996) (due to preexisting purchase contract between the partnership and condemning authority, the transfer was attributable to the partnership under § 1033). Also, note the following general condition under Rev. Proc. 2002-22, § 6, 2002-14 IRB 733 to get a ruling that ownership of undivided interests in real estate does not result in a partnership: ".03 . . . the co-owners [must not have] held interests in the Property through a partnership or corporation immediately prior to the formation of the co-ownership."

162 I.R.C. § 1031(a)(2)(D); *see* WELLER & DRUCKER, *supra* note 157, § 7.12 *et seq*.

163 I.R.C. § 1031(a)(1). Note that I.R.S. Form 1065, Schedule B, Question 14, asks "At any time during the tax year, did the partnership distribute to any partner a tenancy-in-common or other undivided interest in partnership property?" *See also* Rev. Proc. 2002-22, *supra* note 161, which requires, as a condition to a ruling on there not being a disguised partnership, that the property not have been held through a partnership "immediately prior to the formation of the co-ownership."

164 *See* Lipton & Gruen, *supra* note 158, at 278.

[165] *See, e.g.*, Chan, *supra* note 158 ("[A]dvisors most conservatively cite a two year period based on language in PLR 8429039, or a one year period based on un-enacted proposed amendments to § 1031 proposed in the 1980s. Of course getting a taxpayer to wait one or two years . . . may be impossible . . . , so if the taxpayer can be convinced to wait until the next taxable year to complete the transaction, many tax advisors would be pleased.").

[166] Treas. Regs. § 301.7701-3(a), (b)(ii).

[167] *See, e.g.*, Rev. Rul. 99-6; PLR 200807005 (Feb. 15, 2008); PLR 200909008 (Feb. 27, 2009); WELLER & DRUCKER, *supra* note 157, § 2.14A, at 2-15–2-16; Kumar, *Acquiring Partnership Interests in a Like-Kind Exchange*, 120 TAX NOTES 573 (Aug. 11, 2008).

[168] WELLER & DRUCKER, *supra* note 157, § 2.14A, at 2-15–2-16.